TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 311

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

JEAN F. STERN, TRANSFEREE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 25, 1957
CERTIORARI GRANTED OCTOBER 14, 1957

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 311

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

JEAN F. STERN, TRANSFEREE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

INDEX

[fol. a]

IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 12,840

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

JEAN F. STERN, Transferee, Respondent

Petitioner's Appendix—Filed April 10, 1957

[File endorsement omitted.]

[fol. 1] IN THE TAX COURT OF THE UNITED STATES

DOCKET ENTRIES

1953

Nov. 16—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 17—Copy of petition served on General Counsel.

Nov. 16—Request for Circuit hearing in Cincinnati, Ohio filed by taxpayer. 11/30/53—Granted.

1954

Jan. 8—Answer filed by General Counsel.

Jan. 14—Copy of answer served on taxpayer, Cincinnati, Ohio.

Feb. 15—Reply to answer filed by taxpayer. Copy served.

June 21—Hearing set Sept. 20, 1954, Cincinnati, Ohio.

Aug. 19—Motion for a continuance filed by General Counsel. 8/20/54—Granted.

1955

Mar. 21—Hearing set June 13, 1955, Cincinnati, Ohio.

June 14—Hearing had before Judge Murdock on the merits, Stipulation of Facts filed at hearing, Briefs due 7/29/55; Replies due 8/29/55. Appearance of Walter E. Barton, Esq. filed at hearing.

July 1—Transcript of Hearing 6/14/55 filed.

1955

July 29—Brief filed by taxpayer—11/25/55—Copy served.

July 29—Motion for extension to Sept. 29, 1955 to file brief by General Counsel. 8/4/55—Granted.

Sept. 29—Motion for extension to Oct. 29, 1955 to file brief filed by General Consel. 10/4/55—Granted.

Oct. 31—Motion for extension to Nov. 28, 1955 to file brief filed by General Counsel. 10/4/55—Granted.

Nov. 23—Brief filed by Respondent. Served 11/25/55.

[fol. 2] 1956

Jan. 26—Memorandum findings of fact and opinion filed, Judge Murdock, Decision will be entered for the Respondent. 1/27/56—Copy served.

Jan. 27—Decision entered, Judge Murdock, Div. 3.

Feb. 7—Petition for Review by U. S. Court of Appeals for the Sixth Circuit with assignments of error filed by petitioner.

Feb. 7—Statement of Points on Review, filed by Petitioner.

Feb. 7—Designation of record with statement of service by mail thereon, filed by Petitioner.

Feb. 7—Proof of service of petition for review and statement of points filed.

IN THE TAX COURT OF THE UNITED STATES

PETITION FOR REDETERMINATION—Received and Filed November 16, 1953

I

The petitioner, Jean F. Stern, herewith petitions this honorable Court for the relief of a deficiency of Federal income tax as determined in a 90 day letter from T. Coleman Andrews, Commissioner of Internal Revenue by H. R. Kasson, Associate Chief, Appellate Division, U. S. Treasury Department, as disclosed by a letter dated August 17, 1953; copy of said letter is attached hereto.

II

The deficiency as transferee of the Estate of Milton J. Stern, deceased, transferor, for the year ending December

31, 1944, income tax $4,675.74, penalty $2,337.87; for the year ending December 31, 1945, income tax $6,470.01, penalty $3,235.01; for the year ending December 31, 1946, income tax $6,645.70, penalty $3,322.85; for the year ending December 31, 1947, income tax $3,885.27, penalty $2,205.06.

[fol. 3]

III

The petitioner alleges that she is not the transferee of the Estate of Milton J. Stern, deceased. The petitioner states that at no time did the petitioner receive any assets as transferee from the Estate of Milton J. Stern. The petitioner further states that she is not the recipient as transferee of the Estate of Milton J. Stern of an amount of $21,676.72 as alleged tax nor of an amount of $11,100.79 alleged as penalty for income tax of Milton J. Stern, deceased. The petitioner is not an heir, legatee, devisee, or distributee of the alleged transferor or of the Estate of Milton J. Stern. The alleged transferor was not insolvent at any time.

IV

Wherefore, the petitioner, J[illegible]n F. Stern, prays this honorable Court that she not be held liable as transferee of the Estate of Milton J. Stern, deceased, transferor, or in any amount as alleged in the proposed deficiency by the Commissioner and that she be further absolved of all and any liability as transferee.

(Signed) William H. Beck, 705 Security Trust Bldg., Lexington, Kentucky, Attorney for Petitioner.

[fol. 4] ATTACHMENT TO PETITION

Deficiency Letter

U. S. Treasury Department, Office of the District Commissioner, Internal Revenue Service, Cincinnati Region, Appellate Division

Room 621 Federal Building, Louisville 1, Kentucky, August 17, 1953

Registered.

Mrs. Jean F. Stern, 114 Dentaler Court, Lexington, Kentucky.

DEAR MRS. STERN:

You are advised that the determination of the income tax liability of the Estate of Milton J. Stern, Deceased, Lexington, Kentucky, for the taxable years ended December 31, 1944, December 31, 1945, December 31, 1946, and December 31, 1947, discloses a deficiency of $21,676.72 and penalty of $11,000.79, as shown in the statement attached. The amount of the deficiencies stated, together with penalty, and interest as provided by law, constituting your liability as transferee of assets of the Estate of Milton J. Stern, Deceased, will be assessed against you.

In accordance with existing internal revenue laws, notice is hereby given of the deficiencies mentioned and of your transferee liability.

Within 90 days from the date of the filing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiencies and for your liability as transferee. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal Holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays, and legal holidays are to be counted in the computing the 90-day period.

[fol. 5] Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Regional Commissioner, Appellate Division, Federal Building, Louisville 1, Kentucky. The signing and filing

of this form will expedite the closing of your returns by permitting an early assessment of the liability, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours, T. Coleman Andrews, Commissioner; By H. R. Kasson, Associate Chief, Appellate Division.

In the Tax Court of the United States

Statement

In re: Estate of Milton J. Stern, Deceased, Transferror, Lexington, Kentucky

Tax Liability for the Taxable Years Ended December 31, 1944, December 31, 1945, December 31, 1946, and December 31, 1947.

Mrs. Jean F. Stern, Transferee, 114 Dantaler Court, Lexington, Kentucky.

Income Tax

Year	Deficiency	50% Penalty
1944	$ 4,675.74	$ 2,337.87
1945	6,470.01	3,235.01
1946	6,645.70	3,322.85
1947	3,885.27	2,205.06
Total	$21,676.72	$11,100.79

[fol. 6] The records of this office indicate that assets of the above-named decedent's estate were transferred to you during the year 1949.

It is held that you, as transferee of assets, are liable, at law or in equity, for deficiencies in Federal income tax and penalties due from the Estate of Milton J. Stern, Deceased, Adalin Stern Wichman, Executrix, for the years 1944 to 1947, inclusive, in the respective amounts above stated, together with interest as provided by law, and such liability is hereby asserted under Section 311 of the Internal Revenue Code.

The 50 per cent penalty shown herein for the taxable years ended December 1944 to December 31, 1947, inclusive, has been asserted in accordance with the provisions of Section 293 (b) of the Internal Revenue Code.

It has been determined that credit for dependents claimed for Miss Theresa Stern, sister, and Mrs. Jessie Stern, mother, are unallowable as the chief support of these individuals was not furnished by Doctor Stern. Surtax exemption for Mrs. Jean F. Stern, wife, is allowed for each of the above-mentioned years.

A copy of this letter and statement has been mailed to your representative, Mr. William H. Beck, 612 Security Trust Building, Lexington, Kentucky, in accordance with the authority contained in the power of attorney executed by you.

In the Tax Court of the United States

Answer—Filed January 8, 1954

Comes now the Commissioner of Internal Revenue by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein admits, denies and alleges as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

[fol. 7] III. Denies the allegations contained in paragraph III of the petition.

IV. Denies generally each and every allegation contained in the petition not hereinabove specifically admitted, qualified or denied.

V. Respondent, for further answer, alleges as follows:

(a) That during the year 1949, the estate of Milton J. Stern, deceased, without consideration, diverted and transferred to petitioner, assets having an aggregate then fair market value of not less than the deficiency in tax, penalties and interest thereon, which are here in dispute.

(b) That by reason of said transfer, without consideration, from the estate of Milton J. Stern, deceased, to petitioner, said estate of Milton J. Stern, deceased, was, or be-

came, insolvent and unable to pay the deficiencies in tax, penalties and interest thereon, here in dispute.

(c) That no part of the deficiencies in tax, penalties and interest thereon, here in dispute, has been paid.

(d) That consequently pursuant to section 311(a)(1) of the Internal Revenue Code, petitioner became, and is now, liable as transferee of the estate of Milton J. Stern, deceased, for the deficiencies in tax, penalties and interest thereon, here in dispute.

VI. Further answering the petition herein, respondent alleges as follows:

(a) That for the years 1944 to 1947, inclusive, Milton J. Stern, (now deceased, whose estate is petitioner's transferor,) filed income tax returns which disclose net income and income tax liabilities in the amounts as follows, to wit:

Year	Net Income	Income Tax
1944	$ 5,885.06	$ 976.26
1945	7,550.57	1,454.67
1946	6,759.08	975.49
1947	10,262.56*	2,471.65

* Per amended return.

[fol. 8] (b) That for the years 1944 to 1947, inclusive, Milton J. Stern, (now deceased, whose estate is petitioner's transferor,) in fact, derived net income and incurred income tax liabilities in the amounts as follows, to wit:

Year	Net Income	Income Tax
1944	$17,384.01	$ 5,652.00
1945	21,604.28	7,924.68
1946	22,864.43	7,621.19
1947	20,427.35	6,356.92

(c) That the statements of net income and income tax liabilities contained in the returns filed by Milton J. Stern, (now deceased, whose estate is petitioner's transferor,) as alleged in subparagraph (a), *supra*, were deliberately and purposely made by Milton J. Stern, (now deceased, whose estate is petitioner's transferor,) with the intent to evade tax and to defraud the United States Government of its lawfully due revenue for the taxable years 1944, to 1947, inclusive.

(d) That the principal differences between Milton J. Stern's net income per return and his correct net income for

each of the taxable years 1944 through 1947 inclusive, as set forth above, were the result of his having fraudulently with intent to evade tax omitted from net income per return a portion of the fees paid him by his patients.

(e) That the omissions from net income of said fees were the direct result of Milton J. Stern having falsified and manipulated his books and records for the express purpose of defeating and evading the tax due thereon.

(f) That by reason of Milton J. Stern, (now deceased, whose estate is petitioner's transferor,) willful and intentional understatement of taxable net income and consequent understatement of income tax liabilities for the years 1944 to 1947, inclusive, as aforesaid, the returns of the petitioner's decedent for said years are false and fraudulent, and each of the deficiencies in controversy, due, in whole [fol. 9] or in part, to fraud with intent to evade tax, and that, in addition to the deficiencies in controver-y, there are due by and owing from the petitioner's decedent, under the provisions of section 293(b) of the Internal Revenue Code, penalties for the taxable years 1944 to 1947, inclusive, in the respective amounts of $2,337.87; $3,235.01; $3,322.85; and $2,205.06.

Wherefore, it is prayed that:

1. The petition be denied;

2. The determination of the respondent be in all respect approved;

3. The court find and hold that petitioner is a transferee of the Estate of Milton J. Stern, deceased, and is liable as such for the deficiency in tax and penalties thereon here in controversy.

(Signed) Daniel A. Taylor LGF, Chief Counsel
Internal Revenue Service.

IN THE TAX COURT OF THE UNITED STATES

REPLY—Filed February 15, 1954

The above-named petitioner, for reply to the allegations affirmatively set out by the respondent in his answer, admits and denies as follows:

I

Admits the allegations contained in Paragraphs I and II of the petition.

II

The petitioner alleges that the allegations contained in Paragraph III of the petition are true and further alleges that at no time was Milton J. Stern insolvent; at no time did Milton J. Stern transfer with or without consid- [fol. 10] eration any property which would defeat the right of his creditors; that there was no attempt by Milton J. Stern to defeat the claim of the respondent nor of any other creditors; all conveyances made by Milton J. Stern or by his estate were made for adequate consideration; at no time was he insolvent.

III

The petitioner contends that each and every statement set out in the petition is true and that a general denial as set out in Paragraph IV of the answer is of no consequence but is merely a general "catchall" denial of the allegations contained in the petition.

IV

In reply to the allegations of the answer, the petitioner denies the statement contained in Paragraph V (a) of the answer that during the year 1949, "the estate of Milton J. Stern, deceased, without consideration, diverted and transferred to the petitioner assets having an aggregate then fair market value of not less than the deficiency in tax, penalties and interest thereon, which are here in dispute." The petitioner alleges that the estate of Milton J. Stern did not, nor has it at any time, transferred to her any assets having an aggregate fair market value of the deficiency in tax, penalties and interest thereon which are here in

dispute. Further the petitioner alleges that if an amount had been transferred to her that said amount is in a sum far less than the tax, penalties and interest herein asserted.

For reply to Paragraph V (b) of the answer as alleged, "that by reason of said transfer, without consideration, from the estate of Milton J. Stern, deceased, to petitioner, said estate of Milton J. Stern, deceased, was or became, insolvent and unable to pay the deficiencies in tax, penalties and interest thereon, here in dispute."

The petitioner for her reply alleges that there was no transfer made to her from the estate of Milton J. Stern [fol. 11] to the extent of said estate becoming insolvent and unable to pay the deficiencies in tax, penalties and interest thereon.

The petitioner in reply to Paragraph V (c) of the answer of the respondent, "that no part of the deficiencies in tax, penalties and interest ther~~eon, here in~~ dispute, has been paid." The petitioner in reply to this paragraph of the answer states that payments have been made from various sources upon the deficiencies in tax, penalties and interest thereon.

The petitioner in reply to the answer of the Commissioner, Paragraph V (d), "that consequently, pursuant to Section 311A-1 of the Internal Revenue Code, the Commissioner became, and is now, liable as transferee of the estate of Milton J. Stern, deceased, for the deficiencies in tax, penalties and interest thereon, here in dispute," replies that she is not liable as the transferee of the estate of Milton J. Stern, deceased, or for the deficiencies in tax, penalties and interest thereon; that she has not received from the estate of Milton J. Stern assets in the aggregate fair market value of the amount of the deficiencies in tax, penalties and interest here in dispute, nor has she received any sums from the estate of Milton J. Stern; further that any sums that she may have received have been for good and valid considerations; further if she has received any sums that the aggregate fair market value of said sums is far less than the deficiencies in tax, penalties and interest. The petitioner did not become and is not liable as a transferee of the estate of Milton J. Stern.

V

In reply to Paragraphs VI (a), VI (b), VI (c), VI (d), VI (e), and VI (f) of the respondent's answer, the petitioner denies generally each and every allegation specifically contained therein. Further, the petitioner specifically denies that she is the transferee of any of the estate of Milton J. Stern, deceased; that she received any of the [fol. 12] estate of the deceased and further at no time was Milton J. Stern insolvent and further that if she should be held as the transferee of any assets the fair market value of said assets would be much less than the alleged tax, penalties and interest here in controversy.

Wherefore, it is prayed that the affirmative relief requested by the respondent in his answer be denied and that the court hold that the petitioner is not liable as transferee of the estate of Milton J. Stern, deceased, in the amount as alleged or in any amount.

Respectfully submitted, William H. Beck, 705 Security Trust Bldg., Lexington, Kentucky, Attorney for Petitioner.

IN THE TAX COURT OF THE UNITED STATES

STIPULATION OF FACTS—Filed June 14, 1955

It is stipulated that the following facts are true:

1. The petitioner, Jean F. Stern, also known as Eugenia F. Stern, is the widow of Dr. Milton J. Stern and resides in Lexington, Kentucky.

2. Dr. Milton J. Stern died on June 12, 1949, a resident of Lexington, Kentucky. Adalin Stern Wichman, his daughter, is executrix of his estate, which was duly admitted to probate in the County Court of Fayette County, Lexington, Kentucky.

3. The income tax liability of Dr. Milton J. Stern for the taxable years 1944 through 1947 was litigated before this court by his estate in Docket No. 31924. This court herein decided (Tax Court Memo. 1955-40) that the net income

and tax libility of that estate for Dr. Stern's income taxes for those years was as follows:

[fol. 13]

Taxable Years	Net Income Determined	Income Tax Deficiency	Sec. 293(b) Penalty
1944	$17,384.01	$ 4,675.74	$ 2,337.87
1945	21,604.28	6,470.01	3,235.01
1946	22,864.43	6,645.70	3,322.85
1947	20,427.35	3,885.27	2,205.06

These liabilities of Dr. Stern and his estate have not been paid. The assets of the estate are not sufficient to satisfy the foregoing liabilities for income tax and penalty.

4. The following shows the amount of life insurance carried by Dr. Milton J. Stern on his life at the time of his death, of which this petitioner was the beneficiary from the dates indicated up to the date of death, the cash surrender value of said policies as of the date of death, the amount of proceeds received in cash by the petitioner on certain policies, and the present values (figures at 4 percent) as at the date of death of future payments to be received by petitioner on the remaining policies:

Dkt. No. 51271

Issued Date	Life Ins. Company	Policy Number	Face Amount	Date Petr. Named Beneficiary	Cash Surrender Value at Date of Death	Value of Proceeds to Petr. at Date of Death
7-26-30	Pacific Mutual	765279	$ 5,000.00	7-26-30	$ 1,685.00	$ 5,001.65*
12-26-29	Pacific Mutual	743985	1,000.00	12-26-29	625.35	1,000.55*
9-30-11	Northwestern Mutual	895969	5,000.00	3-13-19	2,401.90	5,000.00*
9-9-15	Northwestern Mutual	1110950	5,000.00	3-13-19	2,321.00	4,034.65**
3-20-19	Northwestern Mutual	1196991	5,000.00	3-20-19	2,362.05	4,034.65**
3-20-19	Northwestern Mutual	1196992	5,000.00	3-20-19	2,362.05	4,034.65**
5-18-23	Northwestern Mutual	1656464	1,000.00	5-18-23	439.93	980.59*
10-6-28	Northwestern Mutual	21112085	3,000.00	7-11-34	1,180.89	2,420.79**
9-29-32	Northwestern Mutual	2438131	3,000.00	7-11-34	1,007.82	2,420.79**
6-30-32	Provident Mutual	690009	2,000.00	6-30-32	669.06	2,019.64*
4-24-31	Massachusetts Mut.	1007342	6,755.00	4-24-31	3,608.10	5,200.00*
4-25-34	Mut. Ben. of Newark	1629792	2,500.00	5-7-34	881.18	1,500.00**
10-5-28	Mut. Ben. of Newark	1367521	10,000.00	5-26-34	5,602.67	3,625.00**
9-2-21	Mut. Life of N. Y.	2940373	1,500.00	9-2-21	643.71	1,491.97*
11-4-35	Mut. Ben. of Newark	1702801	1,000.00	11-18-39	334.79	1,010.93*
7-10-33	Mut. Ben. of Newark	1594749	2,500.00	7-10-33	837.18	2,506.16*
1-6-34	Bus. Men's Assur. Co.	185314	1,000.00	1-6-34	297.00	1,000.00*
	Totals				$27,259.68	$47,282.02

* Cash proceeds.

** Present value at date of death of future payments.

[fol. 15]. 5. Dr. Stern retained the right to change the beneficiary and to draw down the cash surrender value on each of the policies in paragraph 4 above.

6. At the time of the issue of all policies, except Northwestern Mutual No. 895969 issued September 30, 1911, Dr. Milton J. Stern was a resident of the State of Kentucky and continued to be one to the time of his death.

7. Dr. Milton J. Stern at the time of his death owned all of the following except the two items marked with an asterisk:

Stocks		$ 3,468.15
*U. S. Treasury Bonds		7,800.00
Cash on deposit, First National Bank & Trust Co., Lexington, Ky.	$ 1,313.70	
Cash in safe	723.00	2,036.70
*Real estate:		
Farm of 10 acres, with improvements	21,000.00	
Residence, Dantzler Court, Lexington, Ky.	15,000.00	36,000.00
Miscellaneous:		
Household furniture	4,921.25	
1 Cow	140.00	
Account Receivable	3,000.00	
Office Equipment	1,200.00	
Ford Automobile	900.00	
Optical Rebate Receivable	648.24	10,809.49
		$60,114.34

* The U. S. Treasury Bonds and real estate were held in joint titles with right of survivorship by Dr. Milton J. Stern and petitioner.

Although Dr. Stern left a will, petitioner has renounced that will and elected to take as widow under the Common-[fol. 16] wealth of Kentucky. To date no distributions have been made from that estate to petitioner.

(Sgd. Walter E. Barton, William H. Beck, Counsel for Petitioner; (Sgd.) John Potts Barnes, Chief Counsel, Internal Revenue Service, Counsel for Respondent.

In the Tax Court of the United States

Memorandum Opinion—Filed January 26, 1956

Murdock, *Judge:* The Commissioner determined that the petitioner was liable as a transferee for deficiencies and

additions thereto for the years 1944, 1945, 1946 and 1947 due on income of Milton J. Stern. The only issue for decision is whether the petitioner is liable as a transferee. All of the facts in the record have been stipulated and, as stipulated, are adopted as the findings of fact.

The petitioner is the widow of Milton J. Stern, a doctor, who died testate on June 12, 1949, while residing in Lexington, Kentucky. The tax liability of Milton J. Stern for the years 1944 through 1947 has been decided by this Court in a prior proceeding and there is no dispute about the amounts owed. Those liabilities have not been paid and the assets of his estate are not sufficient to pay those amounts.

Milton carried a number of policies of life insurance on his own life in which Jean was named beneficiary prior to and up to the date of Milton's death. Milton retained the right to change the beneficiary and to draw the cash surrender value of each of those policies up to the date of his death. The total cash surrender value of the policies at the date of his death was $27,259.68, and the value of the [fol. 17] proceeds of the policies to Jean at the date of Milton's death was $47,282.02 consisting of cash proceeds and the then present value of future payments under the policies. The stipulation is that Milton "carried" the policies on his life and "retained the right to change the beneficiary and to draw down the cash surrender value on each of the policies." The Court concludes from the stipulation that Jean contributed nothing toward the payment of the premiums or the carrying of the policies.

This Court has held in *Christine D. Muller*, 10 T.C. 678, that:

> * * * the Federal Government can follow the property of the transferor, including the proceeds of life insurance, into the hands of such a person [the beneficiary] for the purpose of collecting taxes lawfully due from the transferor, without regard to the limitations of state law. *Pearlman* v. *Commissioner*, 153 Fed. (2d) 560; *Kieferdorf* v. *Commissioner*, 142 Fed. (2d) 723; certiorari denied, 323 U. S. 733. * * *

The *Kieferdorf* case was an affirmance of *May R. Kieferdorf*, 1 T.C. 772, and the *Pearlman* case was an affirmance of *Florence Pearlman, Transferee*, 4 T.C. 34. See also

Sadie D. Leary, 18 T.C. 139; *Aura Grimes Bales, Transferee*, 22 T.C. 355. This Court has followed those cases in other cases and follows them in this case despite reversals in other cases. See *Rowen* v. *Commissioner*, 215 F. 2d 641 and *Tyson* v. *Commissioner*, 212 F. 2d 16, relied upon by the petitioner.

Decision will be entered for the respondent.

IN THE TAX COURT OF THE UNITED STATES

DECISION—Entered January 27, 1956

Pursuant to the determination of the Court, as set forth in its Memorandum Opinion, filed January 26, 1956, it is

Ordered and Decided: That the petitioner is liable as transferee of the Estate of Milton J. Stern, Deceased, for [fols. 18-20] income tax and additions to tax, together with interest thereon as provided by law, as follows:

Year.	Income Tax Deficiency	Additions to Tax Sec. 293(b)
1944	$4,675.74	$2,337.87
1945	6,470.01	3,235.01
1946	6,645.70	3,322.85
1947	3,885.27	2,205.06

Entered Jan. 27, 1956.

(Signed) J. E. Murdock, Judge.

[fols. 21-24] MINUTE ENTRY OF ARGUMENT AND SUBMISSION—December 13, 1956

[Omitted in printing]

IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

JUDGMENT—Filed February 26, 1957

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby reversed.

[fol. 25] [File endorsement omitted]

In United States Court of Appeals for the Sixth Circuit

No. 12840

Jean F. Stern, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

On Petition for Review of Decision of the Tax Court

Opinion—Decided February 26, 1957

Before Simons, Chief Judge; Stephens * and McAllister, Circuit Judges

McAllister, Circuit Judge:

Jean F. Stern, petitioner, was the beneficiary of seventeen insurance policies, of the face amount of $60,255.00, on the life of her husband, Dr. Milton J. Stern, who died June 12, 1949. Dr. Stern, in the contracts of insurance, had reserved the right to change the beneficiary, as well as to draw the cash surrender value of the policies up to the time of his death. However, he never did draw any of the cash surrender values. Petitioner had been named beneficiary in the policies at various times between March 19, 1919—thirty years before her husband's death—and July 11, 1934—fifteen years before her husband's death.

Six years after Dr. Stern's death, respondent Commissioner of Internal Revenue, determined that petitioner was subject to the income tax liability of her deceased husband with regard to the proceeds of the life insurance policies on the ground that she was a transferee of such proceeds,

* Albert Lee Stephens of the Ninth Circuit.

and that the Estate of Milton J. Stern, Deceased, had transferred these proceeds to her. The Commissioner, in his answer to Mrs. Stern's petition, set forth that "during the year 1949, the estate of Milton J. Stern, deceased, without [fol. 26] consideration, diverted and transferred to petitioner, assets having an aggregate then fair market value of not less than the deficiency in tax, penalties and interest thereon, which are here in dispute," and that "by reason of said transfer, without consideration, from the estate of Milton J. Stern, deceased, to petitioner, said estate of Milton J. Stern, deceased, was, or became, insolvent and unable to pay the deficiencies in tax, penalties and interest thereon here in dispute." There was no evidence and no finding of insolvency as of any date prior to decedent's death; and there was no evidence or finding that decedent took out or maintained the policies with intent to hinder, delay or defraud his creditors. The Tax Court agreed with the respondent's contention and held that the government could follow the proceeds of the insurance policies into the hands of the beneficiary.

In *Tyson* v. *Commissioner of Internal Revenue*, 212 F. 2d 16, (C.A. 6), the same question was before this court, and the Commissioner contended in similar fashion that the beneficiary of a life insurance policy was a transferee of a deceased taxpayer in respect of the proceeds of life insurance received after the death of the deceased, under Section 311 of the Internal Revenue Code of 1939. However, in that case, we held that the widow who was the beneficiary of a life insurance policy of her husband's life and who received the proceeds thereof after his death was not liable for his unpaid income taxes, as transferee of her husband's assets, and in so holding, said: "The failure of the husband to change the beneficiary from his wife to his Estate is not a voluntary transfer of the proceeds of said policy within the meaning and scope of the Federal Transferee Statute, Section 311(a)(1)(f) of the Internal Revenue Code."

In *Rowen* v. *Commissioner of Internal Revenue*, 215 F. 2d 641, (C.A. 2), the court held that a widow, who in that case was a beneficiary of a life insurance policy of her deceased husband, was not liable as a transferee under Section 311. The court pointed out that Section 311 applied only to a transferee of the property of a taxpayer, and held that the widow was not a transferee with respect to the

proceeds of the policies, inasmuch as they had never been the property of the deceased taxpayer. The court distinguished Section 311, which was, by its express terms, limited to the collection of income tax obligations, from Section 812, in which the Estate Tax was imposed upon a beneficiary who had received the proceeds of a life insurance [fol. 27] policy "with respect to which the decedent possessed at his death any of the incidents of ownership." The court said that the "failure of Section 311(f) to extend the definition of a transfer to include a 'beneficiary' as was done by I.R.C. Section 900, for purposes of estate tax collection, we think supports our holding that for purposes of income tax collection, a beneficiary was not intended to be classed as a transferee *as to the proceeds of a policy.*" The court declared that while "Congress by specific legislation might have pre-empted the field, it has not chosen to do so. As a result, when Congress extended its general tax-collection procedure to the 'liability' of a transferee, it necessarily must have intended that the existence of liability should be determined by State law. Other than the State law, there is no source to which we may look for pertinent authority." *Rowen* v. *Commissioner of Internal Revenue*, 215 F. 2d 641, 647 (C.A. 2).

In the instant case, the relevant State law is that of Kentucky, which was the State of domicile of petitioner and her deceased husband. According to the statutes of Kentucky, the lawful beneficiary of a life insurance policy is entitled to the proceeds of the policy as against the representatives or creditors of the insured. Section 655 of Kentucky Revised Statutes, 1936, and Section 304.691 of Kentucky Revised Statutes, 1953. Such State statute is applicable to the claim of the Federal government. *Rowen* v. *Commissioner of Internal Revenue*, supra; *United States* v. *Truax*, 223 F. 2d 229 (C.A. 5). Petitioner, accordingly, is entitled to the proceeds of the insurance policies as against the claim herein asserted by respondent.

The Tax Court, however, in the instant case, stated that it would follow its own prior decisions in spite of numerous reversals of such holdings by the Courts of Appeal, specifically alluding to the decision of this court in *Tyson* v. *Commissioner*, supra, as well as the decisions in *Rowen* v. *Commissioner of Internal Revenue*, supra, *United States*

v. *Truax*, supra, and *United States* v. *New*, 217 F. 2d 166 (C.A. 7).

In *Stacey Manufacturing Co.* v. *Commissioner of Internal Revenue*, 237 F. 2d 605, this court said in a similar instance that "the tax court of the United States is not lawfully privileged to disregard and refuse to follow, as the settled law of the circuit, an opinion of the court of appeals for that circuit. If the tax court is not bound on questions of law by decisions of the appropriate circuit having jurisdiction, why should any jurisdiction be vested [fol. 28] in circuit courts of appeals to review decisions of the tax court? The district courts of the several circuits also have statutory jurisdiction in tax cases and they are bound to follow the rules of decision pronounced by the United States Court of Appeals having appellate jurisdiction over the particular District Court. The tax court is no less bound to do so. The mere fact that it is a court having jurisdiction in tax cases throughout the United States does not establish the tax court as superior in any aspect to the United States District Courts." We here reaffirm our opinion in *Tyson* v. *Commissioner of Internal Revenue*, supra.

Respondent Commissioner, however, still insists that the Tax Court's opinion should be here followed, in spite of the fact that this Court has expressly ruled to the contrary in *Tyson* v. *Commissioner of Internal Revenue*, supra; but, while so contending, submits that the decision of the Tax Court should also be sustained on what is termed "a lesser position"—that petitioner, if not liable as a transferee of the proceeds of the policies, is nevertheless liable as a transferee of the cash surrender value.

With respect to petitioner's liability as a transferee of the cash surrender value of the policies, we are of the view that petitioner is not so liable.

In the first place, she was not the transferee of the cash surrender value of the policies any more than she was the transferee of the proceeds of the insurance policies. The only person who had any right to receive the cash surrender value was petitioner's husband. After he died, there remained no cash surrender value. Petitioner did not receive the cash surrender value, but received something wholly different in character and in amount—the proceeds

from the insurance policies. As an instance, the cash surrender value to Dr. Stern at the time of his death of one of his policies was $297.00. The value of the proceeds of the policy to Mrs. Stern was $1,000.00. The cash surrender value was never the property of the widow. The life insurance proceeds were never the property of decedent or of his state. They were payable to the widow, not as part of decedent's estate, or as a transferee of his estate, but because her husband had entered into a speculative contract with the insurance company, many years before, that it would pay his widow these sums on a certain contingency —his death; and they further depended upon other contingencies that he would pay the premiums at certain stated times. Under the statute, petition would be liable for [fol. 29] her husband's income taxes only if she had received a transfer of his property at his death. Section 311(a)(1) of the Internal Revenue Code of 1939. She did not receive any transfer of his property at his death. It might well be that if the statutory provisions of the Estate Tax were here applicable to the cash surrender values, the widow would be liable as a beneficiary, since the decedent at his death possessed the incidents of ownership of securing for himself such cash surrender values, Title 26 U.S.C.A., Section 811(g)(2), but this is not a case involving Estate Tax Collection, but, on the other hand, income tax collection; and under the provisions of the income tax statute, the beneficiary widow was not a transferee either of the proceeds of the life insurance policies, or of the cash surrender values.

We are cognizant of the holding by high authority that it is indisputable that policies similar to those in this case were assets of the decedent in his lifetime, as to their cash surrender values, and that, since, under the terms of the policies, nothing passed on his death, it is unrealistic to view his death as wiping out those values. Further, that under the policies, his death was merely the condition upon which the surrender values no longer were payable to the decedent, but became merged in the greater values which the insurers were obligated to pay the beneficiary. *Rowen v. Commissioner of Internal Revenue*, supra. However, with deference to the foregoing view, it appears to us that, upon the death of the insured, the cash surrender values no longer

existed. To say that the cash surrender values on the death of the insured became merged with the proceeds of the policies paid to the widow is figurative. If the cash surrender values became merged with the proceeds paid to the widow, it might be said perhaps that the cash surrender values, in case the policies were forfeited for nonpayment of premiums merged with the profits of the insurance companies. But such a figure of speech does not seem to point the way of resolving the issue.

To deprive the widow of the face value of the policies,—and permit the Collector to take the cash surrender values,—it must be held that the cash surrender values were assets of the decedent in his lifetime; that such cash surrender values were part of the proceeds of the policies paid to the widow; and that the widow received these cash surrender values, under the provisions of the income tax statute, as a transferee of the estate of her husband. None of these propositions seems valid.

[fol. 30] The cash surrender values were not assets of the decedent during his lifetime. In *Murphy* v. *Casey*, 150 Minn. 107, 184 N. W. 783, where policies of life insurance were issued to a man payable at his death to his mother, with the reserved right on his part as the insured to change the beneficiary at any time, and the option was reserved to the insured to receive the cash surrender values, on his demand, without right of restraint from the beneficiary, it was held that the right or option reserved to the insured to surrender the policies and demand the cash surrender values could not be attached or levied upon by a creditor whose claim arose subsequent to the issuance of the policies, so long as the right of the beneficiary to the ultimate payment of the policies, at the insured's demand, remain in force and effect. In the foregoing case, the applicable state statute provided:

> "Whenever any insurance is effected in favor of another, the beneficiary shall be entitled to its proceeds against creditors and representatives of the person effecting the same." [1]

[1] The state statute here applicable is phrased in substantially the same terms: "When a policy of insurance is effected by any person on his own life or on another life

The sole issue, insofar as is here relevant, was the asserted right of the judgment creditor to resort to, and levy execution upon, the interest of the insured in the cash surrender options and values thereof. In deciding the case, the Supreme Court of Minnesota held that the policies in question, so long as they remained without change of beneficiary, by death or otherwise, were exempt from the claims of creditors; and that the interest of the insured, sought to be reached, was not available to such creditors. The court said "To grant the relief . . . would in our view of the matter wholly destroy the intent of the statute and deprive beneficiaries in such cases of the protection the Legislature intended to secure to them. While it is true that the insured may cash in his policy without regard to the wishes of the beneficiary, that reserved right, since the insurance was effected and taken out for the benefit of the latter, to give force and effect to the statute, must, as to creditors seeking to exercise it in the place and stead of the insured, be [fol. 31] deemed and held subordinate to the rights of the beneficiary. There are no sound reasons, either in morals or in equity and good conscience, why a creditor, to the detriment of the beneficiary, should be given the right and privilege of the insured in such cases. No credit is extended to the insured on the faith of the insurance, for all persons dealing with him are bound to know the law and that money to become due thereon when payable to a third person is exempt from their claims. The statute is wise in its purpose, securing as it does after the death of the insured, pecuniary aid and assistance to the beneficiary, usually someone who is dependent upon the insured for support, and should not be frustrated or impaired by opening the door to those who have no just or equitable claim to the money. The authorities sustain this view of the question. *In Re Johnson* (*D.C.*), 176 Fed. 591, involved the construction of our statute in Federal Bankruptcy pro-

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in favor of some person other than himself, having an insurable interest therein, the lawful beneficiary thereof, other than himself or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same . . ." Section 655 of Carroll's Ky. Statutes (1936). To the same effect is Section 304.691 of Ky. Revised Statutes of 1953.

ceedings, and the conclusion stated was there applied. The court followed the rule of other federal courts and held that the insurance polciy there involved did not pass to the trustee in bankruptcy, for the reason that *it was exempt* under our statute *to the beneficiary.* (Emphasis supplied.) *In Re Pfaffinger* (*D.C.*), 164 Fed. 526; *Holden* v. *Stratton*, 196 U. S. 202, 25 Sup. Ct. 656, 49 L. Ed. 1018; *Hiscock* v. *Mertens*, 205 U. S. 202, 27 Sup. Ct. 488, 51 L. Ed. 771. . . . To hold with plaintiff on either point would result in the destruction of rights the Legislature intended to secure to the beneficiaries in such insurance contracts. To extend to the creditor the option to surrender the policy for the cash value would wipe out the rights of the beneficiary altogether. . . . Other uncertainties and questions readily are suggested, all to the detriment of the beneficiary and all impairing the rights intended to be secured by the statute. The court should not create a situation which will bring about results of the kind.

In Re Pfaffinger, supra, was a case from the District Court for the Western District of Kentucky, and involved the identical state statute here before us. Under that statute it was provided that a lawful beneficiary designated in a life-insurance policy other than the insured or his legal representatives, shall be entitled to the proceeds thereof as against the creditors or representatives of the insured. The trustee in bankruptcy of the insured sought the cash surrender values of the life insurance policies in which the insured's wife was beneficiary, and according to the terms of which, the insured had the right to change [fol. 32] the beneficiary with the company's consent. The trial court denied the trustee the right to secure the cash surrender values, declaring that the state statute, in the language heretofore quoted, *exempted such policies from liability to the demand of creditors;* that the effect of the Supreme Court's holding in *Holden* v. *Stratton*, supra, gave the Kentucky statute controlling influence in determination of the case; and that in *Lockwood* v. *Exchange Bank*, 190 U. S. 294, the Supreme Court had held that title to exempt property never passes to the trustee, and, accordingly, the District Court held that the cash surrender values did not pass to the trustee in bankruptcy in the case then before it.

It is true that these cases speak of life insurance policies as being exempt from liability to the demands of creditors; and, of course, it is well established that state exemption laws are ineffective against the statutory liens of the United States for federal taxes, and where federal statutes subject to taxation specified property over which the deceased possessed, during his lifetime, the incidents of ownership—such as securing for himself the cash surrender values of life insurance policies—as provided in the statutory provisions of the Estate Tax. But the exemptions mentioned in the foregoing cases are not the ordinary exemptions to which the insured, or the deceased, was entitled as a debtor, under the state laws or the bankruptcy statutes. The exemptions of which those cases speak are exemptions to the beneficiary of life insurance policies.

The cash surrender values were not part of the proceeds of the insurance policies paid to the widow, and to hold otherwise would seem to transform plain language to the advantage of the tax-gathering authority, and to the loss of the widow. The widow did not, in any sense, receive the cash surrender values as a transferee of the estate of her deceased husband. The rights of the parties to this suit, and the rights of all parties concerned in the contract of insurance, depended entirely upon the agreements executed between the insured and the insurance companies that it would pay the husband the cash surrender values, only on his demand, in lieu of paying his widow the amount of the policies after his death. If the insured did not demand such payment, the insurance companies were bound to pay the entire proceeds of the policies to the insured's wife, upon his death. There is a positive moral obligation upon a husband to protect his wife against destitution, by providing insurance for her in case of his death. After [fols. 33-34] a husband has paid premiums for thirty years to insure that his wife will be preserved from suffering and want, it would be contrary to public policy and inhumane to permit creditors, whose claims arose subsequent to the execution of the policies of insurance and subsequent to the payment of the premiums, to snatch from the widow, after her husband's death, the large cash surrender values merely because of the provision in which the husband had reserved a right thereto, which he had never exercised.

No statutes require that such hardship be inflicted upon a widow, whose husband has continuously, during the long course of their marriage, sought to protect her, by providing insurance against the day when she would be left alone.

In this case, the government is in no better position than any other creditor. The insurance was not built up, nor were the premiums paid, at the expense of the government, or in fraud of the government.

In accordance with the foregoing, it follows that petitioner is not liable as a transferee of decedent's estate, or of decedent, in respect of the income taxes and penalties claimed; and the decision of the Tax Court is, therefore, reversed.

[fols. 35-36] Clerk's Certificate to foregoing transcript omitted in printing.

[fols. 37-38] SUPREME COURT OF THE UNITED STATES,
OCTOBER TERM, 1956

No. —

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

JEAN F. STERN (Transferee)

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—May 23, 1957

Upon Consideration of the application of counsel for petitioner.

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 26, 1957.

Harold H. Burton, Associate Justice of the Supreme Court of the United States.

Dated this 23rd day of May, 1957.

[fol. 39] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1957

No. 311

[Title omitted]

ORDER ALLOWING CERTIORARI.—OCTOBER 14, 1957

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE 1957 481085 584

No. 311

In the Supreme Court of the United States

OCTOBER TERM, 1957

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JEAN F. STERN, TRANSFEREE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
ROBERT N. ANDERSON,
A. F. PRESCOTT,
KENNETH E. LEVIN,
Attorneys;
Department of Justice, Washington 25, D. C.

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CITATIONS

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October Term, 1957

No. —

Commissioner of Internal Revenue, petitioner
v.
Jean F. Stern, transferee

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 16a–18a) is not reported. The opinion of the Court of Appeals (Appendix A, *infra,* pp. 8–19) is reported at 242 F. 2d 322.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1957. (Appendix A, *infra,* p. 19.) On May 23, 1957, by order of Mr. Justice Burton, the time for petitioning for a writ of certiorari was extended to July 26, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

Decedent, Dr. Milton J. Stern, was indebted to the Government for income taxes and fraud penalties. He had various life insurance policies as to which he retained, during his life, the right to draw cash surrender values and the right to change the beneficiary. He died leaving an insolvent estate. Respondent, his widow, is the designated beneficiary under the policies. The following questions are presented:

1. Whether respondent is liable, under Section 311 of the Internal Revenue Code of 1939, as a transferee of the cash surrender values of the policies.

2. Whether, more broadly, respondent is liable as a transferee, under the same section of the Code, to the full extent of the net proceeds of the policies.

STATUTES INVOLVED

The pertinent provisions of Section 311 (a) and (f) of the Internal Revenue Code of 1939 and Sections 297.140 and 297.150 of the Kentucky Revised Statutes are set forth in Appendix B, *infra*, pp. 20–22.

STATEMENT

Respondent, Jean F. Stern, is the widow of Dr. Milton J. Stern who died on June 12, 1949, a resident of Kentucky. (R. 12a.)

The income tax liability of Dr. Stern for the taxable years 1944 through 1947 was litigated before the Tax Court, which decided that his estate was liable for \$21,676.72 in additional income taxes and \$11,100.79 in fraud penalties. *Stern* v. *Commissioner*, decided February 15, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,040). These taxes and penalties

have not been paid, and the assets of the estate are not sufficient to satisfy them. (R. 12a–13a.)

There is no evidence that Dr. Stern was insolvent at any time prior to his death, but the assets in his estate amounted to only $16,314.34 (plus United States Treasury bonds and real estate jointly held with his wife and not available for the payment of taxes, amounting to $43,800). (R. 15a.) For purposes of this proceeding, therefore, his estate was insolvent. No distribution of any assets of the estate has been made to Mrs. Stern. (R. 16a.) The record does not account for their disbursal.

Mrs. Stern was the beneficiary of seventeen insurance policies of the face amount of $60,255 on the life of decedent. She was named beneficiary at various times between March 13, 1919, and November 18, 1939, and she continued to be the beneficiary up to the date of decedent's death on June 12, 1949.[3] Until his death, decedent reserved the right to change the beneficiary and to draw the cash surrender value of each of the policies. The total cash surrender values of the policies at the date of his death were $27,259.68. After his death, Mrs. Stern received cash proceeds from certain of the policies in the amount of $25,211.49. The value, as of the date of decedent's death, of future payments to be received by Mrs. Stern on certain other policies is $22,070.53. (R. 13a–15a.)

The Commissioner asserted that Mrs. Stern was the transferee of the entire proceeds of Dr. Stern's insurance and therefore liable for payment of his delinquent taxes and penalties. The Tax Court sustained the Commissioner. (R. 16a–18a.) The Court of

Appeals reversed, holding that the Government could reach neither net proceeds nor cash surrender value. It concluded that there was no transfer of property from decedent to his widow within the meaning of the federal transferee statute (Section 311, *infra,* p. 20), and that, in any event, the matter of a transferee's liability must be determined by state law. (*Infra,* pp. 10–11.) On the latter aspect of the case, the Sixth Circuit relied upon a Kentucky statute which immunizes the beneficiary of life insurance policies from claims against the insured. (*Infra,* pp. 20–22.)

REASONS FOR GRANTING THE WRIT

1. Insofar as the decision below bars the Commissioner from reaching the cash surrender values of the policies, it is in direct conflict with the recent decision of the Court of Appeals for the Third Circuit in *United States* v. *Bess,* 243 F. 2d 675.

In the *Bess* case, the court pointed out that the decedent there involved "possessed just prior to his death, a chose in action [in the amount of the cash surrender values] which he could have collected from the insurance companies in accordance with the terms of the policies" (p. 678). These values, the court held (p. 679), were not wiped out by the decedent's death, "but became merged in the larger values which the insurance companies were obligated to pay to Mrs. Bess. The loan or surrender values were then an item of property and Mrs. Bess was a transferee of them within the meaning of Section 311 (a) (1)." On this proposition, the views of the Third Circuit are fully in accord with those of the Second Circuit.

See *Rowen* v. *Commissioner*, 215 F. 2d 641 (C. A. 2d); cf. *United States* v. *Behrens*, 230 F. 2d 504 (C. A. 2d), certiorari denied, 351 U. S. 919; *United States* v. *Hoper*, 242 F. 2d 468 (C. A. 7th).

The *Bess* decision is also unequivocal in its holding that the liability of a transferee under the federal statute (Section 311) is a "federal tax question" to be decided without regard "to the limitation in the law of any State" (p. 677).[1] See, also, *Pearlman* v. *Commissioner*, 153 F. 2d 560 (C. A. 3d). Indeed, the court noted that, had state law applied, the cash surrender values would not have been reachable in the beneficiary's hands (p. 677, n.). As to the first question presented by this petition, the conflict between the Sixth and Third Circuits, is, therefore, complete.[2]

2. It is the Commissioner's position that the entire proceeds of policies, and not merely the cash surrender values, may be reached in the situation where the insured, during his lifetime, retained the power to change the beneficiary. In the Commissioner's view,

[1] The Second Circuit has not agreed with the Third, however, on this proposition. It has held that state law may effectively limit the liability of the beneficiary (*Rowen* case, *supra*), except where the Government has a lien on the surrender values prior to the insured's death (*Behrens* case, *supra*).

[2] It should be noted that the issue whether state law limitations apply is not limited to transferee situations involving insurance: See *Commissioner* v. *Western Union Tel. Co.*, 141 F. 2d 774 (C. A. 2d), certiorari denied, 322 U. S. 751; *Botz* v. *Helvering*, 134 F. 2d 538 (C. A. 8th); *Liquidators of Exchange Nat. Bank* v. *United States*, 65 F. 2d 316 (C. A. 5th). The issue was reserved by this Court in *Phillips* v. *Commissioner*, 283 U. S. 589, 602.

the retention by the insured of the power to make the proceeds payable to his estate is sufficient to warrant the conclusion that those proceeds are to be treated, for tax purposes, as representing the transferred property of the insured. The Tax Court has sustained the Commissioner's position in a long line of decisions (including the instant case) and continues to adhere to it.[3] The courts of appeals, however, have refused to impose transferee liability to the full extent of the proceeds.[4]

Although there is no inter-circuit conflict on the second (or broader) question raised by this petition, that question is closely related to the first question, as to which there is a direct conflict among the circuits. Indeed, the two questions are frequently presented side-by-side. It would therefore seem appropriate, if this Court should grant certiorari to resolve the conflict as to the first question, that it examine the second question

[3] *Muller* v. *Commissioner*, 10 T. C. 678; *Neely* v. *Commissioner*, decided August 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,188); *Sullivan* v. *Commissioner*, decided January 11, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,006); *Leary* v. *Commissioner*, 18 T. C. 139; *Rowen* v. *Commissioner*, 18 T. C. 874, reversed, 215 F. 2d 641 (C. A. 2d); *Tyson* v. *Commissioner*, decided June 5, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,198), reversed *per curiam*, 212 F. 2d 16 (C. A. 6th); *Bales* v. *Commissioner*, 22 T. C. 355; *Wendell* v. *Commissioner*, decided February 23, 1956 (1956 P-H T. C. Memorandum Decisions, par. 56,040); *Stoumen* v. *Commissioner*, 27 T. C. No. 125.

[4] *Tyson* v. *Commissioner*, 212 F. 2d 16 (C. A. 6th); *Rowen* v. *Commissioner*, 215 F. 2d 641 (C. A. 2d); *United States* v. *New*, 217 F. 2d 166 (C. A. 7th); *United States* v. *Truax*, 223 F. 2d 229 (C. A. 5th); *United States* v. *Bess*, 243 F. 2d 675 (C. A. 3d).

as well, thus laying the entire problem to rest. In urging this course, we note that the right of the Government to reach the proceeds of the life insurance of delinquent taxpayers presents a constantly recurring question and one of substantial importance from the revenue standpoint. We are advised by the Internal Revenue Service that, at the present time, there are known to be 216 cases pending either administratively or in the courts which involve this right. In the aggregate, these 216 cases involve taxes of $11,762,161, life insurance proceeds of $7,616,779, and cash surrender values of approximately $1,677,990.

CONCLUSION

For the reasons stated, this petition for a writ of certiorari should be granted.

Respectfully submitted.

J. Lee Rankin,
Solicitor General.
Charles K. Rice,
Assistant Attorney General.
Robert N. Anderson,
A. F. Prescott,
Kenneth E. Levin,
Attorneys.

July 1957.

433260—57——2

APPENDIX A

1. *Opinion of the Court of Appeals*

No. 12840

United States Court of Appeals for the Sixth Circuit

JEAN F. STERN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT

Decided February 26, 1957

Before SIMONS, *Chief Judge;* STEPHENS* and McALLISTER, *Circuit Judges*

McALLISTER, *Circuit Judge.* Jean F. Stern, petitioner, was the beneficiary of seventeen insurance policies, of the face amount of $60,255.00, on the life of her husband, Dr. Milton J. Stern, who died June 12, 1949. Dr. Stern, in the contracts of insurance, had reserved the right to change the beneficiary, as well as to draw the cash surrender value of the policies up to the time of his death. However, he never did draw any of the cash surrender values. Petitioner had been named beneficiary in the policies at various times between March 13, 1919—thirty years before her husband's death—and July 11, 1934—fifteen years before her husband's death.

Six years after Dr. Stern's death, respondent Commissioner of Internal Revenue, determined that peti-

*Albert Lee Stephens of the Ninth Circuit.

tioner was subject to the income tax liability of her deceased husband with regard to the proceeds of the life insurance policies on the ground that she was a transferee of such proceeds, and that the Estate of Milton J. Stern, Deceased, had transferred these proceeds to her. The Commissioner, in his answer to Mrs. Stern's petition, set forth that "during the year 1949, the estate of Milton J. Stern, deceased, without consideration, diverted and transferred to petitioner, assets having an aggregate then fair market value of not less than the deficiency in tax, penalties and interest thereon, which are here in dispute," and that "by reason of said transfer, without consideration, from the estate of Milton J. Stern, deceased, to petitioner, said estate of Milton J. Stern, deceased, was, or became, insolvent and unable to pay the deficiencies in tax, penalities and interest thereon, here in dispute." There was no evidence and no finding of insolvency as of any date prior to decedent's death; and there was no evidence or finding that decedent took out or maintained the policies with intent to hinder, delay or defraud his creditors. The Tax Court agreed with the respondent's contention and held that the government could follow the proceeds of the insurance policies into the hands of the beneficiary.

In *Tyson* v. *Commissioner of Internal Revenue*, 212 F. 2d 16 (C. A. 6), the same question was before this court, and the Commissioner contended in similar fashion that the beneficiary of a life insurance policy was a transferee of a deceased taxpayer in respect of the proceeds of life insurance received after the death of the deceased, under Section 311 of the Internal Revenue Code of 1939. However, in that case, we held that the widow who was the beneficiary of a life insurance policy of her husband's life and who

received the proceeds thereof after his death was not liable for his unpaid income taxes, as transferee of her husband's assets, and in so holding, said: "The failure of the husband to change the beneficiary from his wife to his Estate is not a voluntary transfer of the proceeds of said policy within the meaning and scope of the Federal Transferee Statute, Section 311 (a) (1), (f) of the Internal Revenue Code."

In *Rowen* v. *Commissioner of Internal Revenue*, 215 F. 2d 641 (C. A. 2), the court held that a widow, who in that case was a beneficiary of a life insurance policy of her deceased husband, was not liable as a transferee under Section 311. The court pointed out that Section 311 applied only to a transferee of the property of a taxpayer, and held that the widow was not a transferee with respect to the proceeds of the policies, inasmuch as they had never been the property of the deceased taxpayer. The court distinguished Section 311, which was, by its express terms, limited to the collection of income tax obligations, from Section 812, in which the Estate Tax was imposed upon a beneficiary who had received the proceeds of a life insurance policy "with respect to which the decedent possessed at his death any of the incidents of ownership." The court said that the "failure of Section 311 (f) to extend the definition of a transferee to include a 'beneficiary' as was done by I. R. C. Section 900, for purposes of estate tax collection, we think supports our holding that for purposes of income tax collection, a beneficiary was not intended to be classed as a transferee *as to the proceeds of a policy*." The court declared that while "Congress by specific legislation might have pre-empted the field, it has not chosen to do so. As a result, when Congress extended its general tax-collection procedure to the 'liability' of a transferee, it

necessarily must have intended that the existence of liability should be determined by State law. Other than the State law, there is no source to which we may look for pertinent authority." *Rowen v. Commissioner of Internal Revenue*, 215 F. 2d 641, 647 (C. A. 2).

In the instant case, the relevant State law is that of Kentucky, which was the State of domicile of petitioner and her deceased husband. According to the statutes of Kentucky, the lawful beneficiary of a life insurance policy is entitled to the proceeds of the policy as against the representatives or creditors of the insured. Section 655 of Kentucky Revised Statutes, 1936, and Section 304.691 of Kentucky Revised Statutes, 1953. Such State statute is applicable to the claim of the Federal government. *Rowen v. Commissioner of Internal Revenue, supra; United States v. Truax*, 223 F. 2d 229 (C. A. 5). Petitioner, accordingly, is entitled to the proceeds of the insurance policies as against the claim herein asserted by respondent.

The Tax Court, however, in the instant case, stated that it would follow its own prior decisions in spite of numerous reversals of such holdings by the Courts of Appeal, specifically alluding to the decision of this court in *Tyson v. Commissioner, supra,* as well as the decisions in *Rowen v. Commissioner of Internal Revenue, supra, United States v. Truax, supra, and United States v. New*, 217 F. 2d 166 (C. A. 7).

In *Stacey Manufacturing Co. v. Commissioner of Internal Revenue*, 237 F. 2d 605, this court said in a similar instance that "the tax court of the United States is not lawfully privileged to disregard and refuse to follow, as the settled law of the circuit, an opinion of the court of appeals for that circuit. If the tax court is not bound on questions of law by de-

cisions of the appropriate circuit having jurisdiction, why should any jurisdiction be vested in circuit courts of appeals to review decisions of the tax court? The district courts of the several circuits also have statutory jurisdiction in tax cases and they are bound to follow the rules of decision pronounced by the United States Court of Appeals having appellate jurisdiction over the particular District Court. The tax court is no less bound to do so. The mere fact that it is a court having jurisdiction in tax cases throughout the United States does not establish the tax court as superior in any aspect to the United States District Courts." We here reaffirm our opinion in *Tyson* v. *Commissioner of Internal Revenue, supra.*

Respondent Commissioner, however, still insists that the Tax Court's opinion should be here followed, in spite of the fact that this Court has expressly ruled to the contrary in *Tyson* v. *Commissioner of Internal Revenue, supra;* but, while so contending, submits that the decision of the Tax Court should also be sustained on what is termed "a lesser position"—that petitioner, if not liable as a transferee of the proceeds of the policies, is nevertheless liable as a transferee of the cash surrender value.

With respect to petitioner's liability as a transferee of the cash surrender value of the policies, we are of the view that petitioner is not so liable.

In the first place, she was not the transferee of the cash surrender value of the policies any more than she was the transferee of the proceeds of the insurance policies. The only person who had any right to receive the cash surrender value was petitioner's husband. After he died, there remained no cash surrender value. Petitioner did not receive the cash surrender value, but received something wholly differ-

ent in character and in amount—the proceeds from the insurance policies. As an instance, the cash surrender value to Dr. Stern at the time of his death of one of the policies was $297.00. The value of the proceeds of the policy to Mrs. Stern was $1,000.00. The cash surrender value was never the property of the widow. The life insurance proceeds were never the property of decedent or of his estate. They were payable to the widow, not as part of decedent's estate, or as a transferee of his estate, but because her husband had entered into a speculative contract with the insurance company, many years before, that it would pay his widow these sums on a certain contingency—his death; and they further depended upon other contingencies that he would pay the premiums at certain stated times. Under the statute, petitioner would be liable for her husband's income taxes only if she had received a transfer of his property at his death. Section 311 (a) (1) of the Internal Revenue Code of 1939. She did not receive any transfer of his property at his death. It might well be that if the statutory provisions of the Estate Tax were here applicable to the cash surrender values, the widow would be liable as a beneficiary, since the decedent at his death possessed the incidents of ownership of securing for himself such cash surrender values, Title 26 U. S. C. A., Section 811 (g) (2), but this is not a case involving Estate Tax collection, but, on the other hand, income tax collection, and under the provisions of the income tax statute, the beneficiary widow was not a transferee either of the proceeds of the life insurance policies, or of the cash surrender values.

We are cognizant of the holding by high authority that it is indisputable that policies similar to those in this case were assets of the decedent in his lifetime, as to their cash surrender values, and that, since, under

the terms of the policies, nothing passed on his death, it is unrealistic to view his death as wiping out those values. Further, that under the policies, his death was merely the condition upon which the surrender values no longer were payable to the decedent, but became merged in the greater values which the insurers were obligated to pay the beneficiary. *Rowen v. Commissioner of Internal Revenue, supra.* However, with deference to the foregoing view, it appears to us that, upon the death of the insured, the cash surrender values no longer existed. To say that the cash surrender values on the death of the insured became merged with the proceeds of the policies paid to the widow is figurative. If the cash surrender values became merged with the proceeds paid to the widow, it might be said perhaps that the cash surrender values, in case the policies were forfeited for nonpayment of premiums merged with the profits of the insurance companies. But such a figure of speech does not seem to point the way of resolving the issue.

To deprive the widow of the face value of the policies,—and permit the Collector to take the cash surrender values,—it must be held that the cash surrender values were assets of the decedent in his lifetime; that such cash surrender values were part of the proceeds of the policies paid to the widow; and that the widow received these cash surrender values, under the provisions of the income tax statute, as a transferee of the estate of her husband. None of these propositions seems valid.

The cash surrender values were not assets of the decedent during his lifetime. In *Murphy v. Casey,* 150 Minn. 107, 184 N. W. 783, where policies of life insurance were issued to a man payable at his death to his mother, with the reserved right on his part as the insured to change the beneficiary at any time, and the

option was reserved to the insured to receive the cash surrender values, on his demand, without right of restraint from the beneficiary, it was held that the right or option reserved to the insured to surrender the policies and demand the cash surrender values could not be attached or levied upon by a creditor whose claim arose subsequent to the issuance of the policies, so long as the right of the beneficiary to the ultimate payment of the policies, at the insured's demand, remain in force and effect. In the foregoing case, the applicable state statute provided:

> Whenever any insurance is effected in favor of another, the beneficiary shall be entitled to its proceeds against creditors and representatives of the person effecting the same.[1]

The sole issue, insofar as is here relevant, was the asserted right of the judgment creditor to resort to, and levy execution upon, the interest of the insured in the cash surrender options and values thereof. In deciding the case, the Supreme Court of Minnesota held that the policies in question, so long as they remained without change of beneficiary, by death or otherwise, were exempt from the claims of creditors; and that the interest of the insured, sought to be reached, was not available to such creditors. The court said "To grant the relief * * * would in our view of the matter wholly destroy the intent of the statute and deprive beneficiaries in such cases of the protection the Legis-

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[1] The state statute here applicable is phrased in substantially the same terms: "When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself, having an insurable interest therein, the lawful beneficiary thereof, other than himself or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same * * *." Section 655 of Carroll's Ky. Statutes (1936). To the same effect is Section 304.691 of Ky. Revised Statutes of 1953.

lature intended to secure to them. While it is true that the insured may cash in his policy without regard to the wishes of the beneficiary, that reserved right, since the insurance was effected and taken out for the benefit of the latter, to give force and effect to the statute, must, as to creditors seeking to exercise it in the place and stead of the insured, be deemed and held subordinate to the rights of the beneficiary. There are no sound reasons, either in morals or in equity and good conscience, why a creditor, to the detriment of the beneficiary, should be given the right and privilege of the insured in such cases. No credit is extended to the insured on the faith of the insurance, for all persons dealing with him are bound to know the law and that money to become due thereon when payable to a third person is exempt from their claims. The statute is wise in its purpose, securing as it does after the death of the insured, pecuniary aid and assistance to the beneficiary, usually someone who is dependent upon the insured for support, and should not be frustrated or impaired by opening the door to those who have no just or equitable claim to the money. The authorities sustain this view of the question. *In Re Johnson* (*D. C.*), 176 Fed. 591, involved the construction of our statute in Federal Bankruptcy proceedings, and the conclusion, stated was there applied. The court followed the rule of other federal courts and held that the insurance policy there involved did not pass to the trustee in bankruptcy, for the reason that *it was exempt* under our statute *to the beneficiary*. (Emphasis supplied.) *In Re Pfaffinger* (*D. C.*), 164 Fed. 526; *Holden* v. *Stratton,* 198 U. S. 202, 25 Sup. Ct. 656, 49 L. Ed. 1018; *Hiscock* v. *Mertens,* 205 U. S. 202, 27 Sup. Ct. 488, 51 L. Ed. 771. * * * To hold with plaintiff on either point would result in the destruction of rights the Legislature intended to secure to the beneficiaries

in such insurance contracts. To extend to the creditor the option to surrender the policy for the cash value would wipe out the rights of the beneficiary altogether. * * * Other uncertainties and questions readily are suggested, all to the detriment of the beneficiary and all impairing the rights intended to be secured by the statute. The court should not create a situation which will bring about results of the kind."

In Re Pfaffinger, supra, was a case from the District Court for the Western District of Kentucky, and involved the identical state statute here before us. Under that statute it was provided that a lawful beneficiary designated in a life insurance policy other than the insured or his legal representatives, shall be entitled to the proceeds thereof as against the creditors or representatives of the insured. The trustee in bankruptcy of the insured sought the cash surrender values of the life insurance policies in which the insured's wife was beneficiary, and according to the terms of which, the insured had the right to change the beneficiary with the company's consent. The trial court denied the trustee the right to secure the cash surrender values, declaring that the state statute, in the language heretofore quoted, *exempted such policies from liability to the demand of creditors;* that the effect of the Supreme Court's holding in *Holden* v. *Stratton, supra,* gave the Kentucky statute controlling influence in the determination of the case; and that in *Lockwood* v. *Exchange Bank,* 190 U. S. 294, the Supreme Court had held that title to exempt property never passes to the trustee, and, accordingly, the District Court held that the cash surrender values did not pass to the trustee in bankruptcy in the case then before it.

It is true that these cases speak of life insurance policies as being exempt from liability to the demands

of creditors; and, of course, it is well established that state exemption laws are ineffective against the statutory liens of the United States for federal taxes, and where federal statutes subject to taxation specified property over which the deceased possessed, during his lifetime, the incidents of ownership—such as securing for himself the cash surrender values of life insurance policies—as provided in the statutory provisions of the Estate Tax. But the exemptions mentioned in the foregoing cases are not the ordinary exemptions to which the insured, or the deceased, was entitled as a debtor, under the state laws or the bankruptcy statutes. The exemptions of which those cases speak are exemptions to the beneficiary of life insurance policies.

The cash surrender values were not part of the proceeds of the insurance policies paid to the widow, and to hold otherwise would seem to transform plain language to the advantage of the tax-gathering authority, and to the loss of the widow. The widow did not, in any sense, receive the cash surrender values as a transferee of the estate of her deceased husband. The rights of the parties to this suit, and the rights of all parties concerned in the contract of insurance, depended entirely upon the agreements executed between the insured and the insurance companies that it would pay the husband the cash surrender values, only on his demand, in lieu of paying his widow the amount of the policies after his death. If the insured did not demand such payment, the insurance companies were bound to pay the entire proceeds of the policies to the insured's wife, upon his death. There is a positive moral obligation upon a husband to protect his wife against destitution, by providing insurance for her in case of his death. After a husband has paid premiums for thirty years to insure that his wife will be preserved from suffering and

want, it would be contrary to public policy and inhumane to permit creditors, whose claims arose subsequent to the execution of the policies of insurance and subsequent to the payment of the premiums, to snatch from the widow, after her husband's death, the large cash surrender values merely because of the provision in which the husband had reserved a right thereto, which he had never exercised. No statutes require that such hardship be inflicted upon a widow, whose husband has continuously, during the long course of their marriage, sought to protect her, by providing insurance against the day when she would be left alone.

In this case, the government is in no better position than any other creditor. The insurance was not built up, nor were the premiums paid, at the expense of the government, or in fraud of the government.

In accordance with the foregoing, it follows that petitioner is not liable as a transferee of decedent's estate, or of decedent, in respect of the income taxes and penalties claimed; and the decision of the Tax Court is, therefore, reversed.

2. *Judgment of the Court of Appeals*

[Caption omitted]

(Filed February 26, 1957)

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby reversed.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(f) *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

(26 U. S. C. 1952 ed., Sec. 311.)

Kentucky Revised Statutes (1944, 2d ed.):

297.140 *Life insurance for benefit of a married woman; premiums paid in fraud of creditors.*—(1) A policy of insurance on the life of any person expressed to be for the benefit of

or duly assigned, transferred or made payable to, any married woman, or to any person in trust for her, or for her benefit, by whomsoever such transfer may be made, shall inure to her separate use and benefit and that of her children, independently of her husband or his creditors or any other person effecting or transferring the policy or his creditors.

(2) A married woman may, without consent of her husband, contract, pay for, take out and hold a policy of insurance upon the life or health of her husband or children, or against loss by his or their disablement by accident. The premiums paid on the policy shall be held to have been her separate estate, and the policy shall inure to her separate use and benefit and that of her children, free from any claim of her husband or others.

(3) If the premium on any policy mentioned in this section is paid by any person with intent to defraud his creditors, an amount equal to the premium so paid, with interest thereon, shall inure to the benefit of the creditors, subject to the statute of limitations.

297.150 *Life insurance for benefit of another; premiums paid in fraud of creditors.*—(1) When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself having an insurable interest therein, the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same.

(2) Subject to the statute of limitations, the amount of any premiums for such insurance paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy, but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance

with its terms, unless, before such payment, the company received written notice by or in behalf of some creditor, with specification of the amount claimed, claiming to recover for certain premiums paid in fraud of creditors.

U. S. GOVERNMENT PRINTING OFFICE: 1957

No. 311

In the Supreme Court of the United States

OCTOBER TERM, 1957

COMMISSIONER OF INTERNAL REVENUE, PETITIONER
v.
JEAN F. STERN, TRANSFEREE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 14–16) is not officially reported. The opinion of the Court of Appeals (R. 17–26) is reported at 242 F. 2d 322.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1957 (R. 16–17). On May 23, 1957, by order of Mr. Justice Burton, the time for filing a petition for certiorari on behalf of the Commissioner was extended to and including July 26, 1957 (R. 26). The Commissioner's petition for certiorari was filed on July 25, 1957, and was granted on October 14, 1957

(R. 27). The jurisdiction of this Court rests upon 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, for purposes of collecting federal income taxes, the beneficiary of life insurance policies, in which the decedent had retained the right to change the beneficiary and to draw the cash surrender value, is to be treated as a transferee (1) of the entire proceeds of the policies, or, alternatively, (2) of the cash surrender values.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are: Sections 311 (a) and (f), 811 (g), 827 (b), 900 (a) and (e) and 3670 of the Internal Revenue Code of 1939; Section 316 of the Revenue Act of 1926; Sections 297.140 (1), 297.140 (2), 297.140 (3), 297.150 (1) and 297.150 (2) of the Kentucky Revised Statutes; Section 81.27 of Treasury Regulations 105; and Section 29.311-1 of Treasury Regulations 111. They are set forth in the Appendix, *infra*, pp. 42–49.

STATEMENT

Dr. Milton J. Stern died on June 12, 1949 (R. 11). At the time of his death, Dr. Stern was carrying seventeen policies of insurance on his life, of which Jean F. Stern, his wife and respondent here, was the beneficiary. The following chart indicates, as to each policy, the date of issuance, face amount, date respondent was named beneficiary, cash surrender value, and the value of the proceeds received or to be received by the beneficiary on the insured's death (R. 12–13):

Issued Date	Life Ins. Company	Policy Number	Face Amount	Date Petr. Named Beneficiary	Cash Surrender Value at Date of Death	Value of Proceeds at Date of Death
7-26-30	Pacific Mutual	765279	$5,000.00	7-26-30	$1,685.00	*$5,001.65
12-26-29	Pacific Mutual	743985	1,000.00	12-26-29	625.35	*1,000.55
9-30-11	Northwestern Mutual	895969	5,000.00	3-13-19	2,401.90	*5,000.00
9-9-15	Northwestern Mutual	1110950	5,000.00	3-13-19	2,321.00	**4,034.65
3-20-19	Northwestern Mutual	1196991	5,000.00	3-20-19	2,362.05	**4,034.65
3-20-19	Northwestern Mutual	1196992	5,000.00	3-20-19	2,362.05	**4,034.65
5-18-23	Northwestern Mutual	1656464	1,000.00	5-18-23	439.93	*980.59
10-6-28	Northwestern Mutual	21112085	3,000.00	7-11-34	1,180.89	**2,420.79
9-29-32	Northwestern Mutual	2438131	3,000.00	7-11-34	1,007.82	**2,420.79
6-30-32	Provident Mutual	690009	2,000.00	6-30-32	669.06	*2,019.64
4-24-31	Massachusetts Mut	1007342	6,755.00	4-24-31	3,608.10	*5,200.00
4-25-34	Mut. Ben. of Newark	1629792	2,500.00	5-7-34	881.18	**1,500.00
10-5-28	Mut. Ben. of Newark	1367521	10,000.00	5-26-34	5,602.67	**3,625.00 [1]
9-2-21	Mut. Life of N. Y	2940373	1,500.00	9-2-21	643.71	*1,491.97
11-4-35	Mut. Ben. of Newark	1702801	1,000.00	11-18-39	334.79	*1,010.93
7-10-33	Mut. Ben. of Newark	1594749	2,500.00	7-10-33	837.18	*2,506.18
1-6-34	Bus. Men's Assur. Co	185314	1,000.00	1-6-34	297.00	*1,000.00
	Totals				$27,259.68	$47,282.02

*Cash proceeds.
**Present value at date of death of future payments.

Dr. Stern retained the right to change the beneficiary and to draw the cash surrender value of each of the above policies (R. 14).

In separate litigation, Dr. Stern was held liable for income tax deficiencies and fraud penalties for the years 1944 through 1947 (*Stern* v. *Commissioner*, decided February 15, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,040)) as follows (R. 11–12):

Taxable Years	Net Income Determined	Income Tax Deficiency	Sec. 293 (b) Penalty
1944	$17,384.01	$4,675.74	$2,337.87
1945	21,604.28	6,470.01	3,235.01
1946	22,864.43	6,645.70	3,322.85
1947	20,427.35	3,885.27	2,205.06

[1] On this policy either the cash surrender value or the value of the proceeds appears to be in error since it is not logical for the surrender value to be greater than the proceeds. However, the figures appear in the record as they do above.

These liabilities totaling $32,777.51 have not been paid, and the assets of Dr. Stern's estate are not sufficient to satisfy them (R. 12).

At the time of his death, Dr. Stern owned the following assets except the two items marked with an asterisk (R. 14):

Stocks		$3,468.15
U. S. Treasury Bonds*		7,800.00
Cash on deposit, First National Bank & Trust Co., Lexington, Ky	$1,313.70	
Cash in safe	723.00	
		2,036.70
Real estate: *		
Farm of 10 acres, with improvements	21,000.00	
Residence, Dantzler Court, Lexington, Ky	15,000.00	
		36,000.00
Miscellaneous:		
Household furniture	4,921.25	
1 Cow	140.00	
Account Receivable	3,000.00	
Office Equipment	1,200.00	
Ford Automobile	900.00	
Optical Rebate Receivable	648.24	
		10,809.49
		$60,114.34

*The U. S. Treasury Bonds and real estate were held in joint titles with right of survivorship by Dr. Milton J. Stern and petitioner.

No distributions from decedent's estate had been made to Mrs. Stern at the time of the stipulation (R. 14).

On August 17, 1953, the Commissioner sent a deficiency letter to Mrs. Stern asserting that she was liable for Dr. Stern's unpaid income tax deficiencies, fraud penalties, and interest as transferee of his estate (R. 4–6). Mrs. Stern petitioned the Tax Court for redetermination of this asserted liability on November 16, 1953 (R. 2–3). The Tax Court held that as beneficiary of Dr. Stern's life insurance policies, Mrs. Stern was liable as transferee of his estate to the extent asserted by the Commissioner, together with interest as provided by law (R. 14–16).

The Court of Appeals reversed, holding that Mrs. Stern was not liable as transferee either of the proceeds or cash surrender value of the insurance policies (R. 17–26).

SUMMARY OF ARGUMENT

I

Under Section 311 of the Internal Revenue Code of 1939, the Commissioner is authorized to collect on an existing liability "at law or in equity" from a transferee in the same manner as he may from the original taxpayer. Transferee liability in equity arises from the transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts. Here Dr. Stern died leaving an insolvent estate which was unable to pay his delinquent income taxes. The Government's position, which was sustained by the Tax Court, is that, because the insured decedent retained the right until his death to change the beneficiary of his life insurance policies, and could therefore have made his estate the beneficiary, his designation of his wife as beneficiary, coupled with the non-exercise of right to designate his estate as beneficiary, made her the transferee of the entire proceeds of the policies, and liable as such to that extent for decedent's delinquent income taxes. The proceeds of the policies constituted *his* assets, available for payment of his debts including the unpaid federal income taxes, and these assets were transferred to her upon his death.

We submit that the Court of Appeals erred in holding that the proceeds of decedent's insurance policies were never his property, and that they were

not transferred to his beneficiary when he died. In upholding the constitutionality of the estate tax as applied to the proceeds of life insurance, this Court held that a transfer of the proceeds occurs upon the death of the insured, and that the taxable estate includes property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. *Chase National Bank* v. *United States*, 278 U. S. 327. It would be illogical and unrealistic to hold that a "transfer" of insurance proceeds from the insured to the beneficiary takes place for estate tax purposes, but not for income tax purposes, upon the insured's death. On the contrary, the terms and history of the pertinent statutory provisions show that, under both the estate and the income tax laws, the insured's death operates as a transfer of the proceeds of the policies to the beneficiary, where during his lifetime the insured retained any incident of ownership such as the right to change the beneficiary or to draw upon the cash surrender value.

The statutory right to proceed against "transferees" came into the income and estate tax law at the same time in the Revenue Act of 1926, c. 27, 44 Stat. 9. By a combination of later statutory provisions, the term as used with respect to the estate tax was made specifically applicable to the beneficiary of life insurance proceeds if the insured possessed at his death any of the incidents of ownership of the policy, such as the right to change the beneficiary or to draw the cash surrender value. The legislative history of the Revenue Act of 1926 indicates that "transferee" originally meant the same with respect to both the estate and income taxes. The legislative history of

the later statutory provisions with respect to the estate tax shows that they were merely intended to make the term "transferee" more specific, without altering its previous meaning. The term is, therefore, to be construed in the same way as to both the estate and income tax; and since it is clear that a beneficiary may be liable as a transferee of the proceeds of insurance for estate tax purposes, in such circumstances he should also be treated as a transferee of the proceeds for income tax purposes.

The fact that, while the insured lives, the beneficiary acquires no vested rights, but only an expectancy, also shows that the transfer must occur upon the death of the insured. Moreover, in a bankruptcy context, this Court has denied significance to the distinction between a policy payable to the insured's estate, the proceeds of which are clearly subject to the payment of decedent's delinquent income taxes, and one which, although payable to a named beneficiary, could, by reason of the insured's retention of the right to change the beneficiary, have been made payable to the insured's estate. *Cohen* v. *Samuels*, 245 U. S. 50.

II

Alternatively, regardless of whether there is a transfer of the entire proceeds, we submit that the beneficiary is a transferee of the cash surrender values of the policies. This Court and others have often explained that for practical purposes the surrender values are the property of the insured while he lives. *New York Life Ins. Co.* v. *Statham*, 93 U. S. 24. Insurance companies actually lay aside and invest a re-

serve fund equal to the surrender value, to be appropriated to the payment of the policy when it falls due. Clearly this value may be reached by the Government to satisfy tax liabilities of the insured while he lives. Several courts of appeals have held that to view the death of the insured as wiping out the surrender values would be unrealistic; rather upon his death they merely cease to be payable to him and merge in the proceeds which are payable to the beneficiary. The court below stands alone in its view that the cash surrender values are not assets of the insured while he lives and that as to them, the beneficiary is not a transferee upon the death of the insured. If the insured had honestly reported his income, or if his fraud had been established prior to his death, these surrender values could have been reached to satisfy his deficiencies and penalties. There is no inequity in depriving his estate of a tax advantage arising solely from the fortuitous combination of his fraud and death before payment of taxes.

III

The holding of the court below that the liability of the transferee was limited by state law is erroneous. In upholding the constitutionality of the transferee provisions of the Revenue Act of 1926, this Court reserved decision on that point. *Phillips* v. *Commissioner,* 283 U. S. 589. Since then several courts of appeals have taken the position that the transferee liability of the beneficiary of life insurance policies for the delinquent income taxes of the insured may be limited by state law. On the other hand, the Court of

Appeals for the Third Circuit has twice held that the need for uniformity of decision in this field requires resort to the general law as declared by federal courts.

Essentially the Government is here seeking to collect a federal income tax. The ultimate liability has been fixed by Congress, and a transferee has been held by this Court to be a taxpayer. *United States* v. *Updike*, 281 U. S. 489. Prior to the Revenue Act of 1926, the Government could recover against transferees only by resorting to a proceeding in equity under the general equitable principle of the trust fund doctrine. Section 280 of the 1926 Act, which became Section 311 of the 1939 Code, did not establish any new transferee liability, but merely authorized the Commissioner to utilize against transferees the same summary collection procedures available against other taxpayers. He could still proceed in a court of equity if he desired. But regardless of the procedure chosen, whether transferee liability exists must be determined as a matter of federal law to achieve uniformity of application throughout the country and to avoid differences in result in identical situations depending on differences in local law. The legislative history of the Revenue Act of 1926 indicates that, by including Section 280, Congress anticipated that uniformity of precedents would be developed in this area by the Board of Tax Appeals.

At all events, the Kentucky statutes held by the court below to limit transferee liability here are exemption provisions and hence not applicable to a proceeding for the collection of federal income taxes. State exemption provisions are not laws applicable to

the United States unless made so by Congress itself. *Fink* v. *O'Neil*, 106 U. S. 272. Congress did make them applicable to bankruptcy, but not to the collection of taxes.

ARGUMENT

I

FOR THE PURPOSE OF COLLECTING FEDERAL INCOME TAXES, THE BENEFICIARY OF LIFE INSURANCE POLICIES OF WHICH THE INSURED RETAINED THE RIGHT TO CHANGE THE BENEFICIARY IS A TRANSFEREE OF THE PROCEEDS OF THE POLICIES

Section 311 of the Internal Revenue Code of 1939 authorizes the Commissioner to collect on an existing liability "at law or in equity" from a transferee in the same manner as he may from the original taxpayer. Under federal law, transferee liability in equity arises upon the transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts. *United States* v. *Hoper*, 242 F. 2d 468 (C. A. 7); 9 Mertens, *Law of Federal Income Taxation*, Section 53.12. In the case at bar, there is no question that the estate of Dr. Stern had insufficient assets to meet its liabilities. The stipulation provides that his income tax liability was litigated and deficiencies and penalties established for the years 1944 through 1947 in the Tax Court (*Stern* v. *Commissioner*, decided February 15, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,040)) in the total amount of

$32,777.51; that this liability has not been satisfied; and that the assets of his estate are insufficient to satisfy it (R. 11–12). It was, of course, a liability of the insured on June 12, 1949, the day he died, even though not asserted by the Commissioner or judicially determined by the Tax Court until later. *United States* v. *Gilmore,* 222 F. 2d 167 (C. A. 5), certiorari denied, 350 U. S. 843.

The Tax Court held that, because the insured decedent retained the right to change the beneficiary of his policies and could therefore have made his estate the beneficiary, the naming and retention of respondent as the named beneficiary constituted, as of the time of his death, a transfer of the proceeds to her making her liable as a transferee. The Court of Appeals reversed, and held, *inter alia,* that the respondent was not a transferee of the proceeds, citing its prior *per curiam* decision in *Tyson* v. *Commissioner,* 212 F. 2d 16, and *Rowen* v. *Commissioner,* 215 F. 2d 641 (C. A. 2). These cases support this holding of the Court of Appeals, as do also the cases of *United States* v. *New,* 217 F. 2d 166 (C. A. 7); *United States* v. *Truax,* 223 F. 2d 229 (C. A. 5); and *United States* v. *Bess,* 243 F. 2d 675 (C. A. 3), certiorari granted, October 28, 1957. Meanwhile the Tax Court, however, has consistently held in numerous cases that under the circumstances here a beneficiary is a transferee of the proceeds. *Muller* v. *Commissioner,* 10 T. C. 678; *Neely* v. *Commissioner,* decided August 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,188); *Sullivan* v. *Commissioner,* decided January 11, 1950 (1950 P-H T. C. Memorandum Deci-

sions, par. 50,000); *Leary* v. *Commissioner,* 18 T. C. 139; *Rowen* v. *Commissioner,* 18 T. C. 874, reversed, 215 F. 2d 641 (C. A. 2); *Tyson* v. *Commissioner,* decided June 5, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,198), reversed *per curiam,* 212 F. 2d 16 (C. A. 6); *Bales* v. *Commissioner,* 22 T. C. 355; *Wendell* v. *Commissioner,* decided February 23, 1956 (1956 P-H T. C. Memorandum Decisions, par. 56,040); *Stoumen* v. *Commissioner,* 27 T. C. 1014, pending on appeal (C. A. 3). In the last named case, the Tax Court reconsidered the question thoroughly, noting its awareness of the appellate decisions to the contrary, and reasserted its prior position.

Essentially the position of these courts of appeals is that Section 311 of the 1939 Code (Appendix, *infra,* p. 42) provided a summary procedure for the enforcement of "the liability, at law or in equity, of a transferee of property of a taxpayer," and that the proceeds of an insurance policy are in no sense ever the property of the decedent.[2] The Tax Court,

[2] In *Rowen* v. *Commissioner, supra,* the Court of Appeals took the position (p. 644) that Section 311 "is directed against those to whom *assets* or *property* which belonged to the decedent and which, but for transfer, could have been distrained in his hands, have been transferred * * *." This appears to raise a plain inconsistency; for in the same opinion, the court held that, although she was not a transferee of the proceeds, the beneficiary was a transferee of the cash surrender values within the meaning of Section 311. Yet the court had previously held that cash surrender values are not distrainable in the hands of the insured (*United States* v. *Metropolitan Life Ins. Co.,* 130 F. 2d 149 (C. A. 2)), although clearly they may be reached by other means (*Knox* v. *Great West Life Assur. Co.,* 212 F. 2d 784 (C. A. 6); *United States v. Ison,* 67 F. Supp. 40 (S. D. N. Y.)).

on the other hand, concluded, in the light of related estate tax provisions and legislative history, that the insurance beneficiary was intended to be classed as a transferee.

In the leading case of *Chase Nat. Bank v. United States*, 278 U. S. 327, the validity of the estate tax law as applied to the proceeds of life insurance was attacked on the ground, *inter alia*, that it was a direct tax on property and void because not apportioned, rather than a tax upon the transfer of property as required by the statute. This Court held that the termination at death of the power of the decedent to change the beneficiaries of the life insurance policies which he had procured, and the consequent passing to the designated beneficiaries of all rights under the policies, freed from the possibility of the further exercise of this power, operated as an effective transfer of the proceeds and was the legitimate subject of a transfer tax for estate tax purposes. The Court said (p. 335):

> A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them and their proceeds for his own benefit during his life which subjects them to the control of a bankruptcy court for the benefit of his creditors, *Cohen v. Samuels*, 245 U. S. 50 (see *Burlingham v. Crouse*, 228 U. S. 459), and which may, under local law applicable to the parties here, subject them in part to the payment of his debts, * * * is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free

> the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death.

Rejecting the taxpayers' contention that the proceeds were not transferred to them from the decedent, but from the insurer, and hence that there was nothing to which a death transfer tax could apply, the Court said (pp. 337–338):

> Obviously, the word "transfer" in the statute, or the privilege which may constitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. * * * Termination of the power of control at the time of death inures to the benefit of him who owns the property subject to the power and thus brings about, at death, the completion of that shifting of the economic benefits of property which is the real subject of the tax, just as effectively as would its exercise, which latter may be subjected to a privilege tax, * * *. *And the non-exercise of the power may be as much a disposition of property testamentary in nature as would be its exercise at death,* * * *. [Italics supplied.]

Since, where decedent retains incidents of ownership, the transfer occurs at death, the estate tax on the proceeds of life insurance is applicable even as to

policies issued prior to passage of the Act providing for the inclusion of the proceeds of policies payable to specific beneficiaries in the gross estate. *Heiner* v. *Grandin,* 44 F. 2d 141 (C. A. 3), affirmed on reargument, 56 F. 2d 1082, certiorari denied, 286 U. S. 561; *Cook* v. *Commissioner,* 66 F. 2d 995 (C. A. 3), certiorari denied, 291 U. S. 660; *Levy's Estate* v. *Commissioner,* 65 F. 2d 412 (C. A. 2). The situation is comparable to that in which the reservation by the settlor of the power to revoke a trust results in the inclusion of the trust corpus in the settlor's estate. Cf. *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339.

It is true, as the Second Circuit pointed out in *Rowen* v. *Commissioner, supra,* that *Chase Nat. Bank* v. *United States, supra,* as well as the other cases cited, was not an income tax case. But the mere statement that only estate tax was involved does not make inapplicable here the broad rationale of the Court's ruling that the word "transfer" cannot be restricted to the passing of particular items of property directly from the decedent to the transferee, but also includes the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. And, as the history of the statutory provisions shows, the word "transfer," which came into both the income and estate tax law in the same Revenue Act, has the same meaning with respect to both taxes.

Turning now to the specific statutory provisions involved, Section 900 (a) (1) of the 1939 Internal Revenue Code (Appendix, *infra,* p. 45) imposes liability upon a transferee of property of a decedent

in respect of the tax imposed under the estate tax chapter of the 1939 Code. Section 900 (e) (Appendix, *infra*, p. 45) defines the term "transferee" to include heir, legatee, devisee, and distributee, and to include a person who under Section 827 (b) (Appendix, *infra*, p. 44) is personally liable for any part of the estate tax. Section 827 (b) in turn imposes liability for the estate tax on a beneficiary who receives property included in the gross estate under Section 811 (g) (Appendix, *infra*, p. 43). Section 811 (g) provides that the gross estate shall include the proceeds of life insurance payable to beneficiaries of policies on the life of the decedent if the decedent possessed at his death any of the incidents of ownership of the policy. Section 81.27 of Treasury Regulations 105 (Appendix, *infra*, pp. 47–48) defines the phrase "incidents of ownership" as including, for example, disjunctively, the right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, *or* to obtain from the insurer a loan against the surrender value of the policy. In view of these provisions, it is indisputable that the beneficiary of life insurance of a decedent, who retained until his death the right to change the beneficiary, is liable as a transferee of property of the decedent in respect of the estate tax.

Section 311 (a) (1) (Appendix, *infra*, p. 42) provides for summary collection from a transferee of property of a taxpayer in respect of the tax imposed under the income tax chapter of the 1939 Code. Sec-

tion 311 (f) (Appendix, *infra*, p. 42) defines the term "transferee" to include heir, legatee, devisee, and distributee. Section 29.311-1 of Treasury Regulations 111 (Appendix, *infra*, p. 49), as well as prior Regulations, broadened the definition of the term "transferee" so that it includes "all other classes of distributees." That definition has acquired the force of law. *Kieferdorf* v. *Commissioner*, 142 F. 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733.

In *Rowen* v. *Commissioner*, 215 F. 2d 641 (C. A. 2), the Court of Appeals relied, to support its position that for purposes of income tax collection a beneficiary was not intended to be classed as a transferee as to the proceeds of an insurance policy, upon the failure of Section 311(f) to extend the definition of a tranferee to include a "beneficiary," as was done by Section 900 (e) of the estate tax when it added to the definition of those who are included in the term "transferee" "a person who, under section 827 (b), is personally liable for any part of the tax." The legislative history of Sections 311 and 900 shows that no such implication can properly be drawn from it.

Sections 311 and 900 were originally enacted as Sections 280 and 316, respectively, of the Revenue Act of 1926, c. 27, 44 Stat. 9. They were intended to be correlative provisions. H. Conference Rep. No. 356, 69th Cong., 1st Sess., pp. 42–45, 50 (1939-1 Cum. Bull. (Part 2) 361, 371–373, 376). The report contained an extensive discussion of Section 280 of the Act at pages 42 through 45. At page 50, there is a brief discussion of Section 316 (Appendix, *infra*, p. 46),

but a more extensive discussion of the section was omitted because, as the report said at page 50, its general effect was explained by the discussion of Section 280. Until 1942, Sections 311 (f) and 900 (e) were identical. At that time Section 900 (e) was amended by Section 411 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which added the phrase "and includes a person who, under section 827 (b), is personally liable for any part of the tax." The legislative history of that amendment shows that it was not intended to change the theory of transferee liability as regards the estate tax in comparison to the income tax, but rather was merely intended to make specific one of the many classes of transferees normally considered to have been implicitly included within the purview of Section 900 from its inception. Thus H. Rep. No. 2333, 77th Cong., 2d Sess., p. 168 (1942-2 Cum. Bull. 372, 495), states briefly that—

> This section also makes more specific the definition of "transferee" in section 900 (e) of the Internal Revenue Code, which, however, is not all-inclusive.

In *Hays* v. *Commissioner,* 34 B. T. A. 808, 815, the Board of Tax Appeals gave effect to the transferee provision of the estate tax by holding that the beneficiaries of life insurance policies, in which the decedent retained until his death the right to change the beneficiaries, were "distributees of property of the decedent," and therefore liable as transferees for unpaid estate taxes. This legislative history and case law justify an analogy between the transferee provisions of the income tax and estate tax to show that for both

purposes a beneficiary was intended to be classed as a transferee as to the proceeds of an insurance policy. And far from being in no sense the property of the decedent, the proceeds of the insurance policies may be classed as part of his gross estate because of his retention of incidents of ownership, in this case the right to change the beneficiary.

The Government's position is supported also by the fact that the beneficiary of a policy of insurance in which the right to change the beneficiary is reserved by the insured, as here, has no vested right therein, but only an expectancy or mere inchoate right. *Royal Arcanum* v. *Behrend*, 247 U. S. 394; *Mutual Ben. Life Ins. Co.* v. *Swett*, 222 Fed. 200 (C. A. 6); *Morgan* v. *Penn. Mut. Life Ins. Co.*, 94 F. 2d 129 (C. A. 8); *Metropolitan Life Ins. Co.* v. *Tye*, 288 Ky. 750; *Hoskins* v. *Hoskins*, 231 Ky. 5, 10. In the *Swett* case, *supra*, the court, after stating that the rule is well settled that, under an ordinary policy of life insurance in which there is no reservation of a right to change the beneficiary, the beneficiary acquires at the moment the policy is issued a vested right which would not be affected by any act of the insured, said (pp. 204–205):

> If, however, by the terms of the policy itself there is reserved to the insured the right, without the consent of the beneficiary, to change the appointee with the assent of the insurer, the beneficiary acquires only an expectancy and not a vested interest during the life of the insured. * * *
>
> * * * Her [the beneficiary's] right was inchoate, a mere expectancy during his lifetime, de-

> pendent on the will and pleasure of her husband as holder of the policy, and could not vest until his death happened with the policy unchanged. *His control over the policy was, subject to its items, as complete as if he himself had been the beneficiary.* [Italics supplied.]

Thus the transfer of the proceeds of an insurance policy in which the insured retains the right to change the beneficiary occurs upon the death of the insured.

Life insurance contracts are not insurance from year to year but rather "entire contracts for life," subject to forfeiture, of course, for failure to perform the conditions required. *McMaster* v. *New York Life Ins. Co.*, 183 U. S. 25, 35 [3]; *Burnet* v. *Wells*, 289 U. S. 670, 679. The premium payments constitute the consideration for the entire assurance for life. *New York Life Ins. Co.* v. *Statham*, 93 U. S. 24. From the moment the insured pays the first premium he acquires an asset which he has the power to do with as he pleases during life and dispose of as he chooses at death. His obligation to pay the premiums is the consideration for the promise of the company to pay the face amount of the policy, less any outstanding loan, at death. His interest in the policy and his right to dispose of it at death are not unlike his power to dispose of other property by will. That which passes to the beneficiary is what the insured purchased by performing his policy obligations and by failing to exercise his policy privileges. The fact that that which the beneficiary receives may be something different from that which the insured

[3] For the minority view that life insurance runs from year to year, with a right of renewal, see *Worthington* v. *Charter Oak Life Insurance Co.*, 41 Conn. 372.

himself normally would receive during his lifetime, namely, the policy proceeds, does not vitiate the fact that by his control over the policy the insured can effect a transfer of the entire proceeds either to a particular beneficiary or to his estate. See *Chase Nat. Bank* v. *United States, supra.*

Certainly a life insurance policy payable to the executors, administrators, or assigns of the insured is his property, subject to the claims of his creditors. *Bank of Minden* v. *Clement*, 256 U. S. 126. When the estate is the beneficiary, the proceeds are subject to payment of the decedent's delinquent income taxes even after having been distributed by the estate. *Kieferdorf* v. *Commissioner*, 142 F. 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733. In *Cohen* v. *Samuels*, 245 U. S. 50, this Court denied significance to the distinction between such a policy and one which, although payable to a named beneficiary, may be made payable to the insured's estate and thus subject to satisfy the claims of his creditors. The Court held that where a bankrupt had reserved the right to change the beneficiary of his insurance policies, which had a cash surrender value at the time of adjudication, those policies became an asset in the trustee even though they were payable to someone other than the bankrupt, his estate, or personal representatives. Referring to the fact that the policies were not payable to the bankrupt or his estate, the Court said (p. 53):

> It is true the policies in question here are not so payable, but they can be or could have been so payable at his own will and by simple decla-

ration. Under such conditions to hold that there was nothing of property to vest in a trustee would be to make an insurance policy a shelter for valuable assets and, it might be, a refuge for fraud.

The same reasoning supports the conclusion here that the proceeds of decedent's insurance policies were "property of a taxpayer" within the meaning of that term as used in Section 311 of the Code by reason of decedent's right to change the beneficiary, an incident of ownership; and that upon decedent's death, they were transferred to the beneficiary without consideration, leaving decedent's estate insolvent. The respondent, therefore, was a transferee of the proceeds, and the Government was entitled to pursue them into her hands to be applied to the payment of decedent's unpaid income taxes.

II

ALTERNATIVELY, REGARDLESS OF WHETHER THERE IS A TRANSFER OF THE ENTIRE PROCEEDS, THE BENEFICIARY IS A TRANSFEREE OF THE CASH SURRENDER VALUE WHICH THE INSURED RETAINED THE RIGHT TO WITHDRAW DURING HIS LIFETIME

Apart from whether the respondent was a transferee as to the entire proceeds of the decedent's life insurance, we submit that the court below erred in holding that the cash surrender values were not assets of the decedent during his lifetime and that the respondent did not become a transferee of the surrender values upon his death. In *New York Life Insurance Co.* v. *Statham*, 93 U. S. 24, this Court discussed the equitable value or cash surrender value of a lapsed policy, explaining that it derived from an excess of

premiums paid over the annual cost of the insurance, and stated (p. 34) that "It belongs, in one sense, to the insured who has paid them, somewhat as a deposit in a savings bank is said to belong to the person who made the deposit."[3a] Due to the impossibility of paying premiums during the Civil War, the policy had lapsed, and the insurance company subsequently refused, under the terms of the policy, to pay anything at all. This Court held that the company would not be liable to the full extent of the face amount, but would be held to return the equitable value, saying (p. 35):

> To forfeit this excess [of premiums paid], which fairly belongs to the assured, and is fairly due from the company, and which the latter actually has in its coffers, and to do this for a cause beyond individual control, would be rank injustice. It would be taking away from the assured that which had already become substantially his property.

The Court expressed the same idea in *Hiscock* v. *Mertens,* 205 U. S. 202, 211–212, and *Burlingham* v. *Crouse*, 228 U. S. 459, 469, quoting and approving the following language of Judge Addison Brown in *In re McKinney,* 15 Fed. 535, 537 (S. D. N. Y.):

> The first of these elements, the surrender value of the policy, arises from the fact that the fixed annual premium is much in excess of the annual risk during the earlier years of the pol-

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[3a] In *Grigsby* v. *Russell*, 222 U. S. 149, 156, the Court said, "On the other hand, life insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property."

> icy, an excess made necessary in order to balance the deficiency of the same premium to meet the annual risk during the latter years of the policy. This excess in the premium paid over the annual cost of insurance, with accumulations of interest, constitutes the surrender value. Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is moneys of the assured deposited with the company in advance to make up the deficiency in later premiums to cover the annual cost of insurance, instead of being retained by the assured and paid by him to the company in the shape of greatly-increased premiums, when the risk is greatest. It is the "net reserve" required by law to be kept by the company for the benefit of the assured, and to be maintained to the credit of the policy. So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not the legal, relation of the company to this fund.

Thus, the flat holding of the court below that the cash surrender values were not the property of the insured while he lived is contrary to the practical view of surrender values taken by this Court. Yet this Court and others have often stated that taxation is an eminently practical matter. *Tyler* v. *United States*, 281 U. S. 497, 503; *Barrett* v. *Commissioner*, 185 F. 2d 150, 151 (C. A. 1); *Kohn* v. *Commissioner*, 197 F. 2d 480, 482 (C. A. 2); *Seward's Estate* v. *Commissioner*, 164 F. 2d 434, 436 (C. A. 4); *Ozark Chemical Co.* v.

Jones, 125 F. 2d 1, 2 (C. A. 10), certiorari denied, 316 U. S. 695.

In *Rowen* v. *Commissioner,* 215 F. 2d 641, 647, the Court of Appeals for the Second Circuit also held, contrary to the view of the court below, that the surrender values were the property of the insured, saying:

> It is indisputable that the policies as to their cash surrender values were assets of the decedent in his lifetime. Since under the terms of the policies nothing passed on his death, it is not realistic to view his death as wiping out these values. Under the policies, his death was merely a condition upon which the surrender values no longer were payable to the decedent but became merged in the greater values which the insurers were obligated to pay the beneficiaries. Thus even though, as we held earlier in this opinion, the *entire* proceeds were never an asset belonging to the decedent, the proceeds to the extent of the cash surrender values which were included therein were property once belonging to the decedent in his lifetime and as to those values the beneficiaries were transferees.

The court in that case went on to hold that although the beneficiaries were transferees of the surrender values they were not liable as such by reason of a state statute. (The next section of this brief is directed toward the latter issue.)

The Court of Appeals for the Second Circuit reexamined the *Rowen* case with respect to the surrender values in *United States* v. *Behrens,* 230 F. 2d 504, certiorari denied, 351 U. S. 919, again holding that such values are in practical effect the property of the insured and are not wiped out upon his death

but merge in the proceeds. In that case the Government contended that a tax lien had attached to the surrender values while the insured lived, and that it remained attached thereto after his death when the surrender values merged in the proceeds. The Court of Appeals agreed.

Essentially the view of the court below conflicts also with its own position in an earlier case, *Knox* v. *Great West Life Assur. Co.*, 212 F. 2d 784 (C. A. 6), where a tax lien on all the property of the insured was held to be enforceable against the cash surrender values of his life insurance. Numerous other cases have held the same. *United States v. Metropolitan Life Ins. Co.*, decided January 14, 1958 (C. A. 4); *Kyle* v. *McGuirk*, 82 F. 2d 212 (C. A. 3); *Smith* v. *Donnelly*, 65 F. Supp. 415 (E. D. La.); *United States* v. *Prudential Ins. Co. of America*, 54 F. Supp. 664 (E. D. Pa.); *United States* v. *Ison*, 67 F. Supp. 40 (S. D. N. Y.); *United States* v. *Royce Shoe Co.*, 137 F. Supp. 786 (D. N. H.); cf.; *United States* v. *Trout*, 46 F. Supp. 484 (S. D. Cal.). Such liens could never have attached to the surrender values in the first place if those values were not property or rights to property belonging to the insured. Section 3670, Internal Revenue Code of 1939 (Appendix, *infra*, pp. 45–46).

The court below stands alone also in its view that the beneficiary is not a transferee of the surrender values. As the Court of Appeals said in *Rowen*, to regard the death of the insured as wiping out those values would indeed be unrealistic. An insurance company actually lays aside and invests a reserve fund equal to the surrender value, to be appropriated to the payment of the policy when it falls due. *New York*

Life Ins. Co. v. *Statham,* 93 U. S. 24, 34. See Vance, *Insurance* (3d ed. 1951), pp. 607–624. Thus, following the insured's death, the surrender value indeed continues to exist and constitutes an actual part of the whole proceeds. In *John Hancock Mut. Life Ins. Co.* v. *Helvering,* 128 F. 2d 745, 747, the Court of Appeals for the District of Columbia stated that—

> as long as the insured pays his premiums * * * part of the money usually builds up an "equity" that may be accumulated, cashed, or diverted into paid up protection, and when the insured dies this "equity" may in a sense be transferred to his beneficiaries who have an important "claim" against the company.

In *United States* v. *Bess,* 243 F. 2d 675, certiorari granted, October 28, 1957, the Court of Appeals for the Third Circuit followed its earlier decision in *Pearlman* v. *Commissioner,* 153 F. 2d 560, and explained its holding to mean that the beneficiary of life insurance policies may be liable as a transferee of the surrender values. In *United States* v. *Hoper,* 242 F. 2d 468, the Court of Appeals for the Seventh Circuit followed *United States* v. *Behrens, supra,* holding that a tax lien attached to the cash surrender values prior to the death of the insured remains enforceable to the extent of the cash surrender values against the proceeds in the beneficiary's hands. The upshot of all these decisions, whether or not involving a lien, is that cash surrender values available to the insured before his death do not just evaporate thereafter, but are indeed transferred to the beneficiary, merged in the proceeds. And if such transfer leaves the estate of the decedent insolvent and unable to pay his de-

linquent income taxes, then the effect is that the beneficiary is a transferee.

That this asset of the decedent which would have been available to satisfy his tax liability had he lived should remain available after his death is entirely equitable and appropriate. A portion of the income taxes which the Government seeks to recover in this proceeding is owing by reason of decedent's fraud in concealing income. That was specifically found by the Tax Court in the previously litigated case (*Stern* v. *Commissioner,* decided February 15, 1955 (1955 P–H T. C. Memorandum Decisions, par. 55,040)), as follows:

> The record does not disclose isolated instances of insignificant omissions or occasional discrepancies, but rather a wholesale scheme of fabrication, misstatement, misrepresentation, perversion, and falsification to cheat the Government out of its lawfully due revenue. That Dr. Stern committed acts with the purpose of evading taxes for each of the years here involved has been proven by clear and convincing evidence.

Dr. Stern was carrying the life insurance policies concerned here all the while he was defrauding the Government of taxes due it (R. 12–13). If he had honestly reported his income, he could have paid the taxes due at a time when he was not insolvent. Or if he had honestly reported his income but failed to pay the taxes due, the Government could have reached the cash surrender values of his insurance while he lived. *United States* v. *Metropolitan Life Ins. Co.,* decided January 14, 1958 (C. A. 4); *Knox* v. *Great West Life Assur. Co.,* 109 F. Supp. 207 (E. D.

Mich.), affirmed, 212 F. 2d 784 (C. A. 6); *Cannon* v. *Nicholas*, 80 F. 2d 934 (C. A. 10). In *United States* v. *Hoper*, 242 F. 2d 468, 470 (C. A. 7), also a case involving the Government's right to follow the surrender values of life insurance into the hands of beneficiaries, the Court of Appeals said:

> Assuming equitable considerations have some place in this proceeding, surely the sudden death of the taxpayer cannot be held against the government and inure to the benefit of defendants. Nor is there anything inequitable or arbitrary about the government's pursuing the defendants to collect the taxpayer's delinquent taxes.

To deprive the Government of the right to reach the surrender values in this proceeding would be to do what this Court has said it would not do—that is, to justify a greater tax advantage to a taxpayer who underpays his correct tax over one who pays in full when due. *United States* v. *Koppers Co.*, 348 U. S. 254, 263; *United States* v. *Gilmore*, 222 F. 2d 167, 169 (C. A. 5), certiorari denied, 350 U. S. 843.

III

SINCE THE PRESENT PROCEEDING IS ONE TO ENFORCE COLLECTION OF A FEDERAL TAX, THE LIABILITY OF THE TRANSFEREE CANNOT BE LIMITED BY STATE LAW

The holding of the Court of Appeals, upon the authority of *Rowen* v. *Commissioner*, 215 F. 2d 614 (C. A. 2), that the liability of a transferee should be limited by state law is, we submit, erroneous. Its origin lies in an earlier decision of the Second Circuit, *Hatch* v. *Morosco Holding Co.*, 50 F. 2d 138, certiorari denied *sub nom. Irving Trust Co.* v. *United States*,

284 U. S. 668,[4] which was followed in *Harwood* v. *Eaton*, 68 F. 2d 12 (C. A. 2), certiorari denied, 292 U. S. 636, which in turn was overruled in *Commissioner* v. *Western Union Tel. Co.*, 141 F. 2d 774 (C. A. 2), certiorari denied, 322 U. S. 751. Meanwhile the Court of Appeals for the Fifth Circuit had also followed the *Morosco Holding Co.* case in *Liquidators of Exchange Nat. Bank* v. *United States*, 65 F. 2d 316. Subsequently the Court of Appeals for the Eighth Circuit reached the same conclusion in *Botz* v. *Helvering*, 134 F. 2d 538, relying on three decisions of this Court, *Freuler* v. *Helvering*, 291 U. S. 35; *Blair* v. *Commissioner*, 300 U. S. 5; and

[4] *Hatch* v. *Morosco Holding Co.*, *supra*, cited three cases in support of this proposition: *United States* v. *Updike*, 281 U. S. 489, 493; *Phillips* v. *Commissioner*, 42 F. 2d 177 (C. A. 2), which was at that time pending on certiorari in this Court; and *Wire Wheel Corp.* v. *Commissioner*, 16 B. T. A. 737, affirmed *per curiam*, 46 F. 2d 1013 (C. A. 2). We find nothing in the *Updike* case which would appear to support the proposition. *Phillips* merely relied on a New York state court decision to support the holding that a transferee of a corporation could be held liable for more than his proportionate share of the corporation's debts. It did not say that transferee liability for taxes was imposed by local law, and when this Court subsequently affirmed (283 U. S. 589), it specifically reserved decision on that point. The basis of the *Wire Wheel Corp.* case, affirmed without opinion by the Court of Appeals, is at best ambiguous, but at most it appears to hold that the Commissioner had failed to exhaust his remedies against the transferor under either state or federal law. Thus these cases are highly doubtful authority for the statement in *Hatch* v. *Morosco Holding Co.*, *supra*, p. 139, that Section 280 of the Revenue Act of 1926 permitted collection from a transferee of taxes owed by the transferor "to the extent that the municipal law makes him liable at law or in equity for the transferor's taxes."

Helvering v. *Stuart*, 317 U. S. 154. More recently, in *United States* v. *Truax*, 223 F. 2d 229 (C. A. 5), a case involving the transferee liability of the beneficiary of life insurance, the Court of Appeals for the Fifth Circuit followed *Rowen* and its own earlier decision in *Liquidators of Exchange Nat. Bank* v. *Commissioner, supra,* in holding that the liability of the transferee must be found in state law. The decisions above, all except *Botz* v. *Helvering, supra,* having their ultimate roots in *Hatch* v. *Morosco Holding Co., supra,* we submit are erroneous. The three decisions of this Court upon which *Botz* v. *Helvering* purports to rely are not transferee cases and, we submit, in agreement with *Pearlman* v. *Commissioner,* 153 F. 2d 560 (C. A. 3), are not in point.[5]

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[5] *Freuler* v. *Helvering*, 291 U. S. 35, concerned the measurement of income from trust property for tax purposes, and this Court held that a decree of a state court having jurisdiction of the trust, determining that annual deductions for depreciation of the trust property should have been taken from gross income before making distributions to life income beneficiaries, and requiring them to make restitution accordingly, established the rights of the parties and was an "order governing the distribution" of income within the meaning of Section 219 (d) of the Revenue Act of 1921, c. 136, 42 Stat. 227.

Blair v. *Commissioner*, 300 U. S. 5, held that the validity of certain assignments of trust income was a question of local law and that a prior decision by the Seventh Circuit, holding that the trust was a spendthrift trust under local law, was not *res judicata* insofar as the local law was determinative of any material point in controversy, because of a supervening decision of the state court. But the liability of the assignor for the tax, if the assignments were valid, was held to be a federal question.

Helvering v. *Stuart*, 317 U. S. 154, held that the grantor of a trust was taxable upon the income thereof under Sections 166 and 167 of the Revenue Act of 1934, c. 277, 48 Stat. 680,

In the case of *Phillips* v. *Commissioner,* 283 U. S. 589, this Court reserved decision of the question whether the liability of a transferee is limited by state law. However, other decisions have pointed to the result for which we contend, and the rationale of Section 311 of the Internal Revenue Code of 1939 (originally Section 280 of the Revenue Act of 1926, *supra*) as explained in its legislative history requires it. In the first place essentially the Government here is seeking to collect a federal income tax. This Court has held that such a proceeding against a transferee "is in every real sense a proceeding in court to collect a tax." *United States* v. *Updike,* 281 U. S. 489, 494. The tax imposed upon the transferor, said the Court, is the basis of the liability, whether sought to be enforced directly against the transferor or by suit against the transferee. The aim in either case is to enforce a tax liability, and "it puts no undue strain upon the word 'taxpayer' to bring within its meaning that person whose property, being impressed with a trust to that end, is subjected to the burden." *United States* v. *Updike, supra,* p. 494. Thus the transferee is a taxpayer and the liability sought to be enforced against him is in reality a tax liability. This being true, state law ought not to be invoked to limit it; for ultimately it is a liability which has been fixed by Congress. The Court of Appeals for the Seventh Circuit in *First Nat. Bank* v. *Commissioner,* 112 F.

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insofar as the trust instrument, construed under state law, allowed any person not having a substantial adverse interest to revest the corpus of the trust in the grantor or to distribute to the grantor any part of the trust income.

2d 260, 262, certiorari denied, 311 U. S. 691, stated this as follows:

> Congress has seen fit, in order to prevent evasion of taxes, to fix a tax liability not only upon the transferor of property but, in case of his inability or failure to pay, likewise upon assets transferred by him.

Earlier the same court said in a transferee case, *Commissioner* v. *Keller,* 59 F. 2d 499, 501, that, although state laws control with respect to questions of property, "as to a question of the kind now under consideration the decisions of the federal courts must prevail."[6] In *United States* v. *Motsinger,* 123 F. 2d 585, 589, a fiduciary was the transferee, and the Court of Appeals for the Fourth Circuit said that it would be the harshest sort of technicality—

> To treat the liability of the fiduciary as an entirely new and independent liability and to close one's eyes to the patent fact that it is, in reality, the old tax liability of the original taxpayer which is being enforced * * *.

The necessity for uniformity in the field of transferee liability for taxes has been recognized by the Court of Appeals for the Third Circuit. In *Pearlman* v. *Commissioner,* 153 F. 2d 560, the court held that the liability of recipients of transferred assets for unpaid taxes of decedents was a federal tax question to be decided on the basis of general law as declared by federal courts, saying (p. 562):

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[6] Although the Seventh Circuit stated that it was following the *Rowen* case in *United States* v. *New,* 217 F. 2d 166, it did so without discussion of this point, which was not necessary to the decision.

> On principle the question seems to us clearly one to be answered without reference to state law limitations. It would not be disputed that, in general, the imposition and collection of federal income tax is a federal function. One of the questions arising from such an undertaking is the determination of when B is to be liable to pay a tax assessed against A. The Congress could, no doubt, have left this question to be variously determined by the laws of the respective states if it had so desired. But in the absence of a clearly expressed intention to do so, we should not infer it, for such variation does not fit into a uniformly applied system of federal taxation.

The court reaffirmed this position in *United States* v. *Bess,* 243 F. 2d 675, 677, certiorari granted, October 28, 1957, adhering to its former ruling "that since there was a federal tax question to be decided it should be decided on general law as laid down by the Federal courts and not be subject to the limitation in the law of any State." Indeed, the court noted that, had state law applied, the cash surrender values would not have been reachable in the beneficiary's hands.

The position taken by the Court of Appeals for the Second Circuit in *Rowen* v. *Commissioner, supra,* that the liability of a transferee must be based on state law because the court knew of no general law as declared by federal courts defining the liability of a transferee is grounded in the idea that the liability of a transferee is a separate question from his status as a transferee. In that court's opinion, one may be a transferee without being liable as such, and *Rowen* indeed held that the beneficiary was a transferee of

the cash surrender values but not liable by reason of state law. This fragmentation of what is essentially a single question of federal law results, we submit, from a highly technical and unwarranted interpretation of Section 311 of the Code. If the question involves two elements, both ought to be decided by federal law.

Section 311 did not establish any new transferee liability, but merely authorized the Commissioner to utilize against transferees the same summary collection procedures available against other taxpayers. *Phillips* v. *Commissioner,* 283 U. S. 589. Prior to the Revenue Act of 1926 the United States in an equity proceeding could recover taxes from transferees without assessment against them, and *Leighton* v. *United States,* 289 U. S. 506, held that such an equity proceeding remained available to the Government even after the creation of the summary remedy. But in none of the cases in which the Government utilized the equity procedure prior to the Revenue Act of 1926 did any court suggest that the liability of a transferee was a separate question from his status as a transferee or that state law was involved. On the contrary, it was universally assumed that one who received property without giving adequate consideration therefor from another who was thereby left insolvent (or in the case of a corporation defunct) and unable to pay his outstanding tax debts was a transferee and liable for payment of the taxes to the extent of the transferred property. See cases collected in *Phillips* v. *Commissioner,* 283 U. S. 589, 592–593, fn. 2; 9 Mertens, *Law of Federal Income Taxation,* Section 53.26. This was

an application of the general equitable principle, known as the trust fund doctrine, applied in the federal courts. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, which merely held that state law had to be applied in diversity cases in federal courts, did not repeal such general principles; they are especially appropriate in tax cases like the one at bar which are essentially federal questions requiring uniformity of liability.[7] See *Burnet* v. *Harmel*, 287 U. S. 103; *United States* v. *Gilbert Associates*, 345 U. S. 361. Cf. *Clearfield Trust Co.* v. *United States*, 318 U. S. 363, 367; *Hinderlider* v. *La Plata Co.*, 304 U. S. 92, 110; *Will* v. *Commissioner*, 62 F. 2d 777, 779 (C. A. 2); *Girard Trust Co.* v. *United States*, 149 F. 2d 872, 874 (C. A. 3); *O'Brien* v. *Western Union Telegraph Co.*, 113 F. 2d 539, 541 (C. A. 1); *Mills* v. *Sarjem Corp.*, 133 F. Supp. 753 (D. N. J.). This Court, moreover, has held in *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233, 236, that the right of a transferee who has paid the tax to contribution from other transferees "arises under the general law." Since, therefore, federal law established transferee liability prior to the Revenue Act of 1926, and since, further, Section 280 of that Act was merely designed as an additional procedural method for the enforcement of

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[7] The *Hinderlider* opinion, handed down the same day as *Erie R. Co.* v. *Tompkins*, *supra*, and written by the same justice, stated (p. 110) that in determining controversies over rights in interstate streams, the federal courts administer a " 'federal common law' upon which neither the statutes nor the decisions of either State can be conclusive."

transferee liability, the Court of Appeals for the Second Circuit was in error in the *Morosco Holding Co.* and *Rowen* cases in relying upon the language of the section to divide a theretofore single issue of federal law into two separate questions, one of which was to be governed by state law.

Congress, we submit, manifested no intention that Section 280 should be interpreted by the courts to limit transferee liability by state law. Such limitations can only result in decisions which, far from being uniform throughout the country, would vary from state to state. But the legislative history of Section 280 shows that Congress intended to promote uniformity. That section was introduced as Senate Amendments Nos. 87 and 88 to the Revenue Act of 1926, and was explained and discussed in H. Conference Rep. No. 356, 69th Cong., 1st Sess., pp. 42-45 (1939-1 Cum. Bull. (Part 2), 361, 371-373). This report stated (p. 43) that it was not meant, through the introduction of Section 280, to change transferee liability under "existing law." As we have shown above, the existing law referred to must have been the general body of federal equitable principles, including the trust fund doctrine.

In addition, the report stated (p. 44):

> The amendment thereby substitutes the specialized and more expeditious procedure of the Board for that of the district courts in equity and will develop through the Board a uniformity of precedents in lieu of the present rather vague principles of law governing the liability

of a transferee for unpaid taxes of a transferor.[8]

The Tax Court, we submit, has consistently attempted in numerous cases to carry out the congressional purpose by imposing transferee liability without regard to the limitations of state law. *Muller* v. *Commissioner*, 10 T. C. 678; *Neely* v. *Commissioner*, decided August 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,188); *Sullivan* v. *Commissioner*, decided January 11, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,000); *Leary* v. *Commissioner*, 18 T. C. 139; *Rowen* v. *Commissioner*, 18 T. C. 874; reversed, 215 F. 2d 641 (C. A. 2); *Tyson* v. *Commissioner*, decided June 5, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,198), reversed *per curiam*, 212 F. 2d 16 (C. A. 6); *Bales* v. *Commissioner*, 22 T. C. 355; *Wendell* v. *Commissioner*, decided February 23, 1956 (1956 P-H T. C. Memorandum Decisions,

[8] The following language of the H. Conference Rep. should also be noted (p. 43):

> By reason of the trust fund doctrine and various State statutory provisions the transferee of assets of an insolvent transferor is ordinarily liable for the accrued and unpaid taxes of the transferor.

The reference "the trust fund doctrine and various State statutory provisions" affirmatively shows that Congress recognized the existence of a trust fund doctrine without regard to state law. The reference to state law merely indicates the desire to take advantage of any additional liability provided for by state statute. Judge Learned Hand, concurring in *Harwood* v. *Eaton*, 68 F. 2d 12, 15 (C. A. 2), certiorari denied, 292 U. S. 636, expressed this thought when he said, "I have some doubt whether this [liability of a transferee] includes only liabilities existing by virtue of the state law, as my brothers believe * * *."

par. 56,040); *Stoumen* v. *Commissioner*, 27 T. C. 1014, pending on appeal (C. A. 3).

At all events, Sections 297.140 and 297.150 of the Kentucky Revised Statutes (Appendix, *infra*, pp. 46–47), held by the Court of Appeals in the instant case to limit the liability of the beneficiary as transferee, are exemption provisions, and for that reason alone not applicable in this proceeding. Just as in the situation where a tax lien has attached it is held that state law may not destroy that lien, so here, where a tax liability is imposed by Congress, the state may not provide exemptions.

The Court of Appeal admits that state laws exempting insurance are inoperative as against federal tax liens, and in fact has itself so held in a case involving a Michigan exemption statute identical in part to the Kentucky statute here. *Knox* v. *Great West Life Assur. Co.*, 212 F. 2d 784 (C. A. 6). The theory upon which the state exemption provisions give way in the face of a federal tax lien is that the federal lien is supreme, whether the exemptions involve homesteads (*Shambaugh* v. *Scofield*, 132 F. 2d 345 (C. A. 5); *United States* v. *Heffron*, 158 F. 2d 657 (C. A. 9), certiorari denied, 331 U. S. 831), spendthrift trusts (*United States* v. *Dallas Nat. Bank*, 152 F. 2d 582 (C. A. 5); *Matter of Rosenberg*, 269 N. Y. 247, certiorari denied *sub nom. Rosenberg* v. *United States*, 298 U. S. 669), or insurance (*Knox* v. *Great West Life Assur. Co., supra*; *Kyle* v. *McGuirk*, 82 F. 2d 212 (C. A. 3)). For the same reason that state exemptions are ineffective as against federal tax liens, they should be ineffective as against the general authority of the fed-

eral government to collect taxes which is contained in the same federal statute. Statements by this Court and others clearly imply that no particular significance attaches to a lien, but rather, generally, that state exemption provisions are inapplicable wherever they conflict with a federal claim for taxes. This Court itself has said "that the laws of the State creating these exemptions are not laws for the United States * * * unless they have been made such by Congress itself." *Fink* v. *O'Neil,* 106 U. S. 272, 276. And certainly they have not been made such by the Internal Revenue Code. However, they were made applicable in bankruptcy by the Federal Bankruptcy Act, and for that very reason the Court of Appeals' reliance, with respect to this issue, on such bankruptcy cases as *Lockwood* v. *Exchange Bank,* 190 U. S. 294; *Holden* v. *Stratton,* 198 U. S. 202; *Hiscock* v. *Mertens,* 205 U. S. 202; and *In re Pfaffinger,* 164 Fed. 526 (W. D. Ky), is altogether misplaced. In *Cannon* v. *Nicholas,* 80 F. 2d 934 (C. A. 10), the Court of Appeals said (p. 935) that "Congress has not in the revenue laws, as it did in bankruptcy, recognized state exemption statutes; nor has it exempted either annuity contracts or life insurance policies." The court held the Colorado statute there involved to be an exemption provision, saying (p. 938) that "As such, it is not applicable to federal taxes." See also *Kyle* v. *McGuirk, supra.* And in *Kieferdorf* v. *Commissioner,* 142 F 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733, although there was no lien on the proceeds of the insurance at the time it was distributed from the decedent's estate, which was the

named beneficiary, to his widow and children, yet the latter were held liable as transferees for the decedent's unpaid income taxes, the court saying (p. 725) that "the California law cannot create exemptions from execution or attachment for the collection of Federal taxes." *Murphy* v. *Casey*, 150 Minn. 107, from which the court below quoted profusely, is inapplicable here because the state exemption statute there was invoked merely as between an insured and his private creditor. No federal tax claim was involved.

We submit that the Kentucky statutes are, accordingly, irrelevant with respect to the present action, and that the transferee liability of Mrs. Stern for her husband's delinquent income taxes is a federal question to be decided on the basis of the general principles established by federal courts.

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code of 1939:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

*   *   *   *   *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

*   *   *   *   *

(f) *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

(26 U. S. C. 311.)

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or

personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

(g) [As amended by Sec. 404 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Proceeds of Life Insurance.*—

(1) *Receivable by the executor.*—To the extent of the amount receivable by the executor as insurance under policies upon the life of the decedent.

(2) *Receivable by other beneficiaries.*—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For the purposes of clause (A) of this paragraph, if the decedent transferred, by assignment or otherwise, a policy of insurance, the amount paid directly or indirectly by the decedent shall be reduced by an amount which bears the same ratio to the amount paid directly or indirectly by the decedent as the consideration in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer. For the purposes of clause (B) of this paragraph, the term "incident of ownership" does not include a reversionary interest.

(3) *Transfer not a gift.*—The amount receivable under a policy of insurance

transferred, by assignment or otherwise, by the decedent shall not be includible under paragraph (2) (A) if the transfer did not constitute a gift, in whole or in part, under Chapter 4, or, in case the transfer was made at a time when Chapter 4 was not in effect, would not have constituted a gift, in whole or in part, under such chapter had it been in effect at such time.

* * * * *

(26 U. S. C. 811.)

SEC. 827. LIEN FOR TAX.

* * * * *

(b) [As amended by Sec. 411 (a) of the Revenue Act of 1942, *supra*] *Liability of Transferee, Etc.*—If the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under section 811 (b), (c), (d), (e), (f), or (g), to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. Any part of such property sold by such spouse, transferee, trustee, surviving tenant, person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien provided in section 827 (a) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, except any part sold to

a bona fide purchaser for an adequate and full consideration in money or money's worth.

* * * * *

(26 U. S. C. 827.)

SEC. 900. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this subchapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a decedent, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this subchapter.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(e) [As amended by Sec. 411 (b) of the Revenue Act of 1942, *supra*.] *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee, and includes a person who, under section 827 (b), is personally liable for any part of the tax.

(26 U. S. C. 900.)

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the

amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 3670.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 316. * * *

* * * * *

(e) As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Kentucky Revised Statutes (1948, 4th ed.):

297.140 *Life insurance for benefit of a married woman: premiums paid in fraud of creditors.* (1) A policy of insurance on the life of any person expressed to be for the benefit of, or duly assigned, transferred or made payable to, any married woman, or to any person in trust for her, or for her benefit, by whomsoever such transfer may be made, shall inure to her separate use and benefit and that of her children, independently of her husband or his creditors or any other person effecting or transferring the policy or his creditors.

(2) A married woman may, without consent of her husband, contract, pay for, take out and hold a policy of insurance upon the life or health of her husband or children, or against loss by his or their disablement by accident. The premiums paid on the policy shall be held to have been her separate estate, and the policy shall inure to her separate use and benefit and that of her children, free from any claim of her husband or others.

(3) If the premium on any policy mentioned in this section is paid by any person with intent

to defraud his creditors, an amount equal to the premium so paid, with interest thereon, shall inure to the benefit of the creditors, subject to the statute of limitations.

297.150 *Life insurance for benefit of another; premiums paid in fraud of creditors.* (1) When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself having an insurable interest therein, the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same.

(2) Subject to the statute of limitations, the amount of any premiums for such insurance paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy, but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms, unless, before such payment, the company received written notice by or in behalf of some creditor, with specification of the amount claimed, claiming to recover for certain premiums paid in fraud of creditors.

Treasury Regulations 105, promulgated under the Internal Revenue Code of 1939:

Sec. 81.27 [As amended by T. D. 5239, 1943 Cum. Bull. 1081, and T. D. 5699, 1949-1 Cum. Bull. 181] *Insurance Receivable by Other Beneficiaries.*—(a) *In case of decedent dying after December 31, 1947.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after December 31, 1947. In such cases, the amount of the aggregate proceeds of all insurance on the life of the decedent not receivable by or for

the benefit of his estate must also be included in his gross estate, as follows:

(1) Such insurance (not includible under (2) of this paragraph) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in the proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, and

(2) Such insurance with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any person.

* * * * *

For the purposes of this section, the term "incidents of ownership" is not confined to ownership in the technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder is an incident of ownership in the decedent. For examples of "incidents of ownership" see paragraph (c) of this section. * * *

* * * * *

(c) * * *

* * * * *

Incidents of ownership in the policy include, for example, the right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. The insured possesses an incident of ownership if his death is necessary to terminate his interest in the insurance, as, for example, if the proceeds would become payable to his estate, or payable as he might direct, should the beneficiary predecease him.

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.311-1 [As amended by T. D. 5458, 1945 Cum. Bull. 45] *Claims in Cases of Transferred Assets.*—The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, as amended (paragraph 81 of the Appendix to these regulations) in respect of any income tax imposed by Chapter 1, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by chapter 1, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with The Tax Court of the United States, and the filing of a petition for review of The Tax Court's decision, are included in the sections of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in tax imposed by chapter 1.

The term "transferee" as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 19..

No. 311

IN THE

Supreme Court of the United States

October Term, 1957

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JEAN F. STERN,
Respondent, Transferee.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Respondent, Transferee.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The respondent, transferee, respectfully opposes the granting of the writ of certiorari prayed for by the petitioner herein for the reasons hereinafter stated.

QUESTIONS PRESENTED

Respondent disagrees with petitioner's statement of questions presented (Pet. 2-4) and states them to be as follows:

1. Whether respondent, as beneficiary of the proceeds of insurance on the life of her deceased husband, is liable at law or in equity as a transferee of property of the decedent's estate in respect of income tax, interest and penalties imposed upon decedent's estate for years prior

to his death, within the meaning of Sec. 311(a)(1), I.R.C. of 1939.

2. Whether the Kentucky statute providing that the lawful beneficiary of a life insurance policy shall be entitled to the proceeds thereof against the creditors and representatives of the insured is applicable to the United States.

3. Assuming respondent to be liable as a transferee of the property of decedent's estate, whether her liability is limited to the excess of the estate's liability for income taxes, interest and penalties over and above the value of the undistributed assets of the estate as of the date of decedent's death.

STATUTES INVOLVED

The statutes are printed in the petition at pages 20-22, except Secs. 827(b), 900 (a), (a)(1), (e) and 1119(a), I.R.C. of 1939, and Title 28, Sec. 1652, U.S.C., which read as follows:

Statutes Applicable to Estate Taxes
Internal Revenue Code of 1939

Sec. 827. (b) *Liability of transferee, etc.*—If the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or *beneficiary*, who receives, or has on the date of the decedent's death, *property included in the gross estate under section 811 (b), (c), (d), (f), or (g)*, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. * * * (*Italics supplied.*)

Sec. 900. *Transferred assets.*

Sec. 900. (a) Method of collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this subchapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

Sec. 900. (a) (1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a decedent, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this subchapter.

Sec. 900. (e) *Definition of "transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee, and includes any person who, under section 827 (b), is personally liable for any part of the tax.

Sec. 1119. *Provisions of special application to transferees.**

Sec. 1119. (a) Burden of proof.—In proceedings before the Board the burden of proof shall be upon the Commissioner to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

Title 28, Sec. 1652, U. S. C.

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the

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* Sec. 6902 (a), I.R.C. of 1954, is the same.

United States, in cases where they apply. (June 25, 1948, c. 646, 62 Stat. 944.)

STATEMENT

Respondent agrees with the statement made by petitioner (Pet. 2-4), except as follows:

1. With respect to insolvency, respondent adopts the statement in the opinion of the Court of Appeals below that:

> "There was no evidence and no finding of insolvency of any date prior to decedent's death; and there was no evidence or finding that the decedent took out or maintained the policies with intent to hinder, delay, or refraud his creditors." (Pet. 9.)

2. In the last paragraph of petitioner's statement (Pet. 3), he said that the Commissioner asserted that respondent was the transferee of the entire proceeds of decedent's insurance and, therefore, liable for the payment of his delinquent income taxes and penalties, and that The Tax Court sustained the Commissioner. Respondent submits that the entire proceeding in The Tax Court was whether respondent, as the beneficiary of the proceeds of insurance on decedent's life, was liable as transferee of the *estate of decedent*, and not whether she was liable as transferee of the *decedent*. (R. 4a, 7a, 10a, 17a.) Moreover, that is what the Court of Appeals below understood the question to be. (Pet. 9.)

REASONS WHY PETITION FOR WRIT SHOULD BE DENIED

1. *Petitioner is asking this Court to pass upon questions never presented to The Tax Court or to the Court of Appeals below.*

The only question before The Tax Court was whether respondent was liable as a transferee of the *estate of decedent* with respect to the *proceeds* of the policies of insurance. (Deficiency letter, R. 4a; Petition, R. 3a; Answer, R. 7a; Reply, R. 10a), and that is the only question decided by The Tax Court. (R. 17a.)

The only question presented to the Court of Appeals below was the same, and the Court of Appeals understood that to be the question. (Pet. 8, 9.)

This Court has held that a question not presented to The Tax Court should not be passed upon by a Court of Appeals for the logical reason that a litigant is entitled to know the basis of the claim against him (*General Utilities Operating Company* v. *Helvering*, 296 U. S. 200, 80 L. Ed. 154, 56 S. Ct. 185); and that a question not raised before The Tax Court and the Court of Appeals will not be considered by this Court on certiorari. (*Helvering* v. *Tex Penn Oil Co.* 300 U. S. 481; 81 L. Ed. 755, 57 S. Ct. 569; *Helvering* v. *Cement Investors*, 316 U. S. 527, 86 L. Ed. 1640, 62 S. Ct. 1125.)

2. *There is no conflict between the decision of the Court of Appeals below and the decision of any other Court of Appeals.*

A. As to the liability of the beneficiary of a life insurance policy with respect to the *proceeds*, all Courts of Appeals which have passed upon the question have held that there is no transferee liability. (*Rowen* v. *Comm.*, (CA 2d, 1954) 215 F (2d) 641, rev'g 18 T. C. 874; *U. S.* v. *New*, (CA 7th, 1954), 217 F (2d) 166, rev'g 125 F. Supp. 312; *Tyson* v. *Comm.*, (CA 6th, 1954), 212 F (2d) 16, rev'g T. C. Memo. Op., Dkt. 37494, PH Memo. Par. 53,198; *U. S.* v. *Truax*, (CA 5th, 1955), 223 F (2d) 229, aff'g U. S. D. C., S. D. Georgia (unreported); *U. S.* v. *Bess*, (CA 3rd, 1957), 243 F (2d) 675, aff'g 134 F. Supp. 467.

B. As to the liability of the beneficiary of a life insurance policy with respect to the *cash surrender value* as a transferee of the *decedent's estate*, no other Court of Appeals has passed upon the question. All of the decisions referred to in the preceding paragraph involved the beneficiary's liability as a transferee of the *decedent* and not as a transferee of his *estate*, except the opinion in the *Truax* case did not indicate specifically what was involved—the liability as a transferee of the decedent or as a transferee of his estate. In any event, the question was not discussed in that case.

3. *The decision of the Third Circuit in the Bess case is contrary to the decisions of this Court on the question of the application of State law to cases involving property rights.*

The Third Circuit in the *Bess* case recognized that under the law of New Jersey, the State wherein the insured resided, the beneficiary wife has a "vested interest" in th proceeds of the policy.* This Court has held that State law governs as to property rights. (*Blair* v. *Comm.*, 300 U. S. 5, 81 L. Ed. 465, 57 S. Ct. 330); and that the law of the State is as much a part of the policy of insurance as though incorporated into the policy. (*Bank of Washington* v. *Hume*, 128 U. S. 195, 32 L. Ed. 370.)

4. *The decision of the Third Circuit in the Bess case is contrary to Title 28, Sec. 1652, U. S. C.*

Sec. 1652 provides that the laws of the several States, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the Courts of the United States, in cases where they apply. Notwithstanding the Third Circuit recognized that the law of New Jersey gave the wife beneficiary a "vested interest" in the proceeds of the insurance, that Court held that she was a transferee with respect to the

* See footnote No. 3 of Court's opinion.

cash surrender value, thereby disregarding the law of that State, contrary to Sec: 1652, U. S. C..

5. *The decision of the Third Circuit in U. S. v. Bess, supra, holding that a transferee's liability in income tax cases is governed by Federal law is clearly erroneous.*

All of the Circuits except the Third Circuit have held that there is no Federal law creating transferee liability, where income taxes are involved, contrasting Sec. 311 (a)(1), (f), which does not include a beneficiary within the definition of transferee for income tax purposes, with Sec. 900 (a)(1), (b), (e), which does include a beneficiary within the definition for estate tax liability. This Court held in *Phillips* v. *Comm.*, 283 U. S. 589, 75 L. Ed. 1289, 51 S. Ct. 608, that Sec. 280 (a)(1) of the Revenue Act of 1926, which contains the same language as Sec. 311 (a)(1), did not create a new transferee liability but "a new remedy for enforcing the *existing* liability at law or in equity" by summary process instead of being compelled to resort to a court of equity, which theretofore had been the only remedy. Although the Third Circuit held that Federal instead of State law applies in determining the liability of a transferee, that Court did not indicate the source of Federal law creating such liability. (*Italics supplied.*)

6. *The fact that The Tax Court consistently holds that a beneficiary of the proceeds of life insurance is liable as a transferee to the extent of the proceeds for the unpaid income taxes of the deceased insured notwithstanding reversals by Courts of Appeals is not a ground for granting certiorari.*

The Tax Court has persisted in disregarding the decisions of Courts of Appeals and has forced the alleged transferee to incur the expense of appeal, even though he resides within the jurisdiction of the Circuit Court which has reversed The Tax Court in a former case

involving the same question. The Court of Appeals below rebuffed The Tax Court for refusing to follow that Court's decision in the *Tyson* case. (Pet. 9, 11.)

CONCLUSION

For the foregoing reasons the petition for writ of certiorari should be denied.

Respectfully submitted,

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No. 311

IN THE

Supreme Court of the United States

October Term, 1957

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JEAN F. STERN,
Respondent, Transferee.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF

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Respondent, Transferee.

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RESPONDENT'S BRIEF

Respondent agrees with the presentation of the petitioner under the following headings:

OPINIONS BELOW

JURISDICTION

STATUTES AND REGULATIONS INVOLVED

Respondent relies upon the following statutes in addition to those printed in petitioner's brief at pp. 42-49:

(INTERNAL REVENUE CODE)

SEC. 811(a). DECEDENT'S INTEREST.

To the extent therein of the decedent at the time of his death;

SEC. 1119(a). BURDEN OF PROOF.

In proceedings before the Board the burden of proof shall be upon the Commissioner to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(UNITED STATES CODE)

TITLE 28, SEC. 1652.

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decisions in civil actions in the courts of the United States, in cases where they apply. (June 25, 1948, c. 646, 62 Stat. 944.)

QUESTIONS PRESENTED

The questions presented in the petition for certiorari were as follows:

"1. Whether respondent is liable, under Section 311 of the Internal Revenue Code of 1939, as a transferee of the cash surrender values of the policies.

"2. Whether, more broadly, respondent is liable as a transferee, under the same section of the Code, to the full extent of the net proceeds of the policies."

Respondent submits that the following additional questions are involved:

3. Whether respondent's liability as transferee of decedent may properly be considered by this Court, when the only issue presented to and decided by The Tax Court was respondent's liability as transferee of the decedent's estate.

4. Whether respondent's liability as transferee with respect to the cash surrender values of the policies may properly be considered by this Court, when the only issue presented to and decided by The Tax Court was respondent's liability as transferee with respect to the proceeds of insurance.

STATEMENT

Respondent agrees with the statement of petitioner, except the following should be added to it, inasmuch as petitioner has the burden of proof with respect to transferee liability:

> There was no evidence and no finding of insolvency as of any date prior to decedent's death; and there was no evidence or finding that decedent took out or maintained the policies with intent to hinder, delay or defraud creditors. (CA Opinion, R. 18.) There was no evidence or finding that decedent paid any of the premiums on the insurance policies during any

of the years with respect to which deficiencies in income taxes were determined or during any of the years subsequent thereto.

SUMMARY OF ARGUMENT

I

Respondent's liability for the unpaid income taxes of decedent depends upon:

(1) Whether the proceeds or cash surrender values were the property of the deceased;

(2) Whether respondent is a transferee of the proceeds or cash surrender values within the meaning of Sec. 311; and

(3) Whether respondent is liable at law or in equity, assuming that she is a transferee.

The proceeds of insurance belonged to the insurance companies and never belonged to the decedent. The proceeds were paid to the respondent pursuant to contracts of insurance, under which decedent agreed to pay the premiums in consideration of the promises of the companies to pay the proceeds to respondent upon decedent's death. That an insurance company pays its own money when it pays the proceeds is evident from the fact that the proceeds are payable upon the death of the insured even though his death may occur immediately after the policy becomes effective.

The Court below in *Stern*, The Second Circuit in *Rowen*, the Third Circuit in *Bess*, the Fifth Circuit in *Truax*, and the Seventh Circuit in *New*, all held that proceeds of insurance do not belong to the insured, and no Court of Appeals has held to the contrary. The Tax Court has been alone in so holding.

Decisions upholding the includibility of proceeds of insurance in the gross estate for estate purposes are not apposite. An analysis of Sec. 811 shows that Congress

did not consider the decedent to have an interest in proceeds of insurance at the time of his death, otherwise they would be includible under Sec. 811(a) and it would not be necessary to include them specifically in Sec. 811(g). The distinction between the interest of a decedent in property and the interest of a beneficiary in proceeds of insurance is recognized by the Courts.

Inasmuch as the proceeds of insurance did not belong to decedent during his lifetime, respondent was not a transferee of property of the decedent with respect to the proceeds. The Court below and the other Circuits referred to above held to this effect.

II

Under the contracts of insurance, decedent was required to pay the premiums in consideration of the insurance companies' promises to pay the proceeds to respondent after his death. The laws of the various states require insurance companies to maintain a reserve for solvency purposes. This reserve is made up of a portion of the level premiums paid by a large group of policyholders, together with interest thereon, and the cash surrender value of a particular policy is considered equitably to be a proratable part of the reserve. If the premiums paid by the insured belong to the companies and never belong to him, and the reserve fund is made up in part of premiums and in part with interest earned thereon, it follows that the cash surrender values never belong to the insured, as they are considered to be a proratable portion of the reserve. If the insured were the owner of the reserve or the cash surrender values, he would have to pay an income tax on the interest accruing in the reserve, and, moreover, he would not be required to pay interest to the company on any loan obtained upon the security of his policies.

Decisions growing out of the Bankruptcy Act are not controlling on the question of whether an insured owns the cash surrender values of his policies, as that Act specifically provides that powers exercisable by the bankrupt for his own benefit devolve upon the trustee. These cases hold that the power of the bankrupt insured to surrender his policy for the cash surrender value is a power devolving upon the trustee; but they do not hold that the bankrupt owns the cash surrender value of his policy.

Decisions involving liens perfected during the decedent's lifetime likewise are not apposite to the question involved herein. Federal tax liens apply to property and to interests of property of the taxpayer. Policies of insurance are property of the taxpayer, and, consequently, the lien applies to them. Liens follow property *cum onere*, and, hence, the Courts have held that the Government is entitled to recover from the beneficiary an amount equal to the value of the policies represented by their cash surrender values at the time of the decedent's death.

The Court below held that the deceased never owned the cash surrender values during his lifetime, and, consequently, that respondent was not a transferee with respect thereto within the meaning of Sec. 311. The Second Circuit in *Rowen* and the Third Circuit in *Bess*, however, held that the decedent owned the cash surrender values during his lifetime and that they merged in the proceeds at the time of his death. This result seems to be incompatible with their unqualified holding that the proceeds always belonged to the companies and never belonged to the insured. If the cash surrender values belonged to the insured during his lifetime and the proceeds always belonged to the companies, it is somewhat difficult to rationalize how property always belonging to the decedent can merge with property always belonging to the companies and still retain its identity in the hands of the beneficiary.

III

Even though respondent were a transferee of the proceeds or of the cash surrender values, she had no liability as a transferee. There is no Federal statute determining the liability of a transferee under Sec. 311, and, accordingly, it is necessary to look to the law of the State, in this case Kentucky.

The Kentucky courts have held that the purpose of the Kentucky Revised Statutes, Secs. 297.140 and 297.150 is to give a married woman a separate estate in the proceeds free from the debts of her husband, the insured; that she has more than a mere expectancy in the proceeds; that it is a right which is subject to be defeated by the insured by changing the beneficiary; and that in the event of her death before the insured, her executor is entitled to the proceeds in the absence of any change in the beneficiary prior to the insured's death.

The Court below discussed the law of Kentucky applicable to insurance polices, but did not rely upon it in view of the Court's holding that the respondent was not a transferee of either the proceeds or the cash surrender values of the policies.

The Second Circuit in *Rowen* and the Fifth Circuit in *Truax* held that State law governed and that under the applicable law of New York and Georgia, respectively, the beneficiary was not liable as a transferee. These laws are in practically the language as the law of Kentucky. The Third Circuit in *Bess* held that the law of New Jersey, which also is practically the same as the law of Kentucky, gave the wife beneficiary a vested interest; but that Court held that the general law as interpreted by Federal Courts applied, not the State law,—without, however, pointing out the general law which rendered the beneficiary liable as a transferee.

In any event, petitioner has the burden of proving that respondent is liable as a transferee of property of the decedent; and this petitioner has failed to do.

IV

The only question before the Tax Court was respondent's liability as a transferee of the decedent's estate with respect to the proceeds of insurance. No issue was raised as to her liability as a transferee of the decedent or regarding her liability with respect to the cash surrender values of the policies. These questions are not properly before this Court.

ARGUMENT

Although respondent contends that the questions presented in the petition for certiorari may not properly be considered by this Court in so far as they apply to the cash surrender values of the policies or with respect to respondent's liability as a transferee of decedent for the reason that they were not presented to or decided by The Tax Court, respondent's argument will be addressed, *first*, to the questions discussed in respondent's brief, and, *second*, to respondent's contention that issues not presented to or decided by The Tax Court are not properly before this Court.

POINT I

Respondent Is Not A Transferee of the Proceeds

Two questions arise under Sec. 311(a)(1), I.R.C. of 1939:

1. Whether respondent is "a transferee of property of a taxpayer;" and

2. Assuming that she is a transferee, whether she has any "liability, at law or in equity." (Pet. Br. 42.)

The first of these questions logically is divisible into two parts:

(1) Were the proceeds of insurance the *property of a taxpayer*, viz., the deceased insured?

(2) Was respondent a *transferee* of the proceeds *within the meaning of Sec. 311(a)(1)?*

I. *The Proceeds Were Not The Property of A Taxpayer*

In Krueger and Waggoner, "The Life Insurance Policy Contract," 1953 Edition, published by The American Society Of Chartered Life Underwriters, the following statement is made with respect to the nature of a life insurance policy:

> "An insurance policy is a contract under which the company agrees that, in consideration of certain payments to it by the policyholder, it will pay a specified amount to the beneficiary at the insured's death. It is not paying the beneficiary the insured's property, but is paying its own funds which are not traceable to any funds received from the policyholder and may be greatly in excess thereof.[1] A beneficiary under an insurance policy is likened to the 'third-party beneficiary' known in other forms of contract law." (P. 83.)

Every Court of Appeals which has passed upon the question to date has held that proceeds of life insurance payable to an individual beneficiary after the death of the insured never belonged to the insured during his lifetime or to his estate after his death, (*Stern* v. *Comm.*, R. 17; 242 F (2d) 322 (CA 6th, 1957); *Tyson* v. *Comm.*, 212 F (2d) 16 (CA 6th, 1954); *Rowen* v. *Comm.*, 215 F (2d) 641 (CA 2nd, 1954); *U. S.* v. *New*, 217 F (2d) 166 (CA 7th, 1954); *U. S.* v. *Truax*, 233 F (2d) 229 (CA 5th, 1955);

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[1] For instance, the entire proceeds become payable upon death, even though death may occur immediately after the policy becomes effective.

U. S. v. *Bess,* 243 F (2d) 675 (CA 3rd, 1957), pending on certiorari, Nos. 395 and 410).[2]

Petitioner admits that these cases' are against him, but he relies upon the following cases upholding the imposition of the estate tax upon the transfer of proceeds of life insurance to an individual beneficiary, where the insured retains the right to change the beneficiary until the date of his death (Pet. Br. 13-15); (*Chase Nat. Bank* v. *U. S.*, 278 U. S. 327, 73 L. Ed. 405, 49 S. Ct. 126 (1929); *Heiner* v. *Grandin,* 44 F (2d) 141 (CCA 3rd, 1930), aff'd on reargument, 56 F (2d) 1082 (1932), cert. den. 286 U. S. 561, 76 L. Ed. 1294, 52 S. Ct. 643 (1932); *Cook* v. *Comm.* 66 F (2d) 995 (CCA 3rd, 1933), cert. den. 291 U. S. 660, 78 L. Ed. 1052, 54 S. Ct. 377 (1934); *Levy's Estate* v. *Comm.*, 65 F (2d) 412 (CA 2nd, 1933).

The 1939 Code imposes an excise tax

> "upon the transfer of the net estate." (Sec. 810.)

The net estate is determined by deducting certain items from the gross estate. (Sec. 812.) The gross estate is determined by

> "including the value at the time of his (decedent's) death of all property * * * (Sec. 811);
>
> "To the extent of the *interest therein of the decedent at the time of his death* (Sec. 811(a)), (Br. 2, *supra.*)
>
> * * * *
>
> "To the extent of *the amount receivable by the executor* as insurance under polices upon the life of the decedent. (See 811(g)(1);
>
> "To the extent of *the amount receivable by all other beneficiaries* as insurance under policies upon the life of the decedent * * *." (Sec. 811(g)(2)). (*Italics supplied.*) (Pet. Br. 43.)

Analysis of these provisions indicates that Congress did not consider that the proceeds of life insurance rep-

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[2] The Tax Court continues to hold to the contrary notwithstanding reversals by Courts of Appeals. (R. 14.)

resented an interest of the decedent at the time of his death, otherwise they would have been covered by Sec. 811(a), and it would not have been necessary to include them specifically in Sec. 811(g)(1) and (2). This conclusion is confirmed by the omission from Sec. 811(g)(1) and (2) of the language "the interest therein of the decedent at the time of his death" contained in Sec. 811(a) and the substitution of the words "the amount receivable by the executor (all other beneficiaries) under policies upon the life of the decedent."

The distinction between the interest of the insured in property at the time of his death and the interest of the beneficiary in proceeds of insurance was recognized in *John Hancock Mutual Life Insurance Co. v. Helvering*, 128 F(2d) 745, 746 (CA D.C., 1942), involving a lien for estate taxes imposed by Sec. 315(b), Rev. Act of 1934, corresponding to Sec. 827(b), I.R.C. of 1939. In its opinion the Court ~~said~~:

> "The imposition of liability appears to follow two lines. First is the case where decedent makes a *transfer* by *trust* or otherwise. Second is the case where *insurance passes* under a contract to a specific *beneficiary*. These two cases are set off by '(1)' and '(2)'. If the tax has not been paid, it is provided that in *either case* the *transferee, trustee,* or *beneficiary* is personally liable. The statute proceeds to impose a lien on the estate *property* to the extent of *decedent's interest* at the time of *transfer* or to the extent of the *beneficiary's interest* under the *insurance* contract. (*Italics the Court's*).

The quotation from the opinion of this Court in *Chase National Bank v. U. S., supra,* (Pet. Br. ~~13~~, 14), shows that the estate tax is not imposed upon the transfer of the proceeds to an individual beneficiary *as the property of the decedent:*

> "Termination of the power of control at the time of death inures to the benefit of *him who owns the property subject to the power* and thus brings about

at death the completion of that *shifting of the economic benefits* which is the real subject of the tax, just as effectively as would its exercise, which later may be subjected to a privilege tax." (*Italics supplied.*)

Other instances where Congress has brought within the purview of the estate tax law property which does not belong to the decedent at the time of his death are irrevocable *inter vivos* transfers made in contemplation of death or intended to take effect in possession or enjoyment at or after death (Sec. 811(c)); revocable transfers (Sec. 811(d)); and transfers of property held as joint tenants or as tenants by the entirety. (Sec. 811(e).) Certainly up to the time of death the decedent has it within his power to revoke a revocable transfer and to sell his interest in a joint tenancy no less than his power to revoke the beneficiary of his life insurance policy.[3]

It has been held that decisions of this Court such as *Tyler* v. *U. S.*, 281 U. S. 497, 74 L. Ed. 991, 50 S. Ct. 356 (1930), *Phillips* v. *Dime Trust & Safe Deposit Co.*, 284 U. S. 160, 76 L. Ed. 220, 52 S. Ct. 46 (1931), and *Gwinn* v. *Comm.*, 287 U. S. 224, 77 L. Ed. 270, 53 S. Ct. 157 (1932), upholding the estate tax upon the transfer of the interest of a decedent in a tenancy by the entirety or in a joint tenancy, are not precedents for the determination of whether his interest therein is his property *within the meaning of Sec. 311(a)(1)*; and that such an interest does not constitute *property of a taxpayer* within the meaning of that section. (*Irvine* v. *Helvering*, 99 F (2d) 265, 270, (CCA 8th, 1938); *Tooley* v. *Comm.*, 121 F (2d) 350, 354, (CCA 9th, 1941); *Parker* v. *Comm.*, 122 F (2d) 230 (CCA 9th, 1941); *U. S.* v. *Hutcherson*, 188 F (2d) 326 (CA 8th, 1951).

[3] Petitioner admitted in his petition for certiorari that the bonds and real estate held in the joint names of decedent and respondent with right of survivorship were "not available for the payment of taxes," referring to decedent's unpaid income taxes. (Pet. 3.)

A priori the decisions of this and other Courts in *Chase National Bank* v. *U. S.*; *Heiner* v. *Grandin*, *Cook* v. *Cook*, and *Levy's Estate* v. *Comm.*, *supra*, relied upon by petitioner, (Pet. Br. 13-15), are not apposite to the question of whether proceeds of insurance are property of a taxpayer within the meaning of Sec. 311(a)(1).

2. *Respondent Is Not A Transferee Of The Property Of The Decedent With Respect To The Proceeds.*

If the proceeds of insurance were not the property of the decedent during his lifetime, then it follows that respondent is not a transferee of property of the decedent with respect to the proceeds.[4] Nor was she a transferee of property of the decedent's estate, as the proceeds were not payable to his estate and never belonged to it. This was the decision of all of the Courts of Appeals which have considered the question. (*Stern* v. *Comm.*, R. 17; 242 F (2d) 322 (CA 6th, 1957); *Tyson* v. *Comm.*, 212 F (2d) 16 (CA 6th, 1954) *Rowen* v. *Comm.* 215 F (2d) 641 (CA 2nd, 1954); *U. S.* v. *New*, 217 F (2d) 166 (CA 7th, 1954); *U. S.* v. *Truax*, 233 F (2d) 229 (CA 5th, 1955); *U. S.* v. *Bess*, 243 F (2d) 675, 678 (CA 3rd, 1957).)

The Court of Appeals for the Second Circuit in the *Rowen* case, *supra*, answered the question as to whether a beneficiary of a life insurance policy is a transferee of the proceeds as follows:

> "Were the beneficiaries of the policies here involved 'transferees' with respect to *the proceeds of the poli-*

[4] The substance of petitioner's argument that decedent is a transferor of the proceeds is that he could have changed the beneficiary of his policies to his estate and thereby subjected the proceeds to the claims of his creditors. Failure to act does not constitute a voluntary transfer of property to defeat the claims of creditors. (*Tyson* v. *Comm.*, 212 F (2d) 16, 17.) This should be all the more true here, where the policies were taken out many years before the Government's claim for delinquent income taxes arose, and where respondent was named the beneficiary at various times ranging from 14 to 30 years before decedent's death.

cies? We think not. In no sense were the *proceeds* ever property of the decedent-taxpayer. Under the policy contracts the decedent never had a right to receive the proceeds. And since at his death the policies were not payable to his estate, the *proceeds* of the policies never passed to his estate and *as to the proceeds* the beneficiaries did not take as legatees or distributees of his estate." (215 F (2d) 641, 644.) (*Italics the court's.*)

This conclusion was concurred in by the Sixth Circuit (*Stern*, R. 17, 19, 242 F (2d) 322, 324), by the Fifth Circuit (*Traux*, 223 F (2d) 229, 231), by the Seventh Circuit (*New*, 217 F (2d) 166, 167), and by the Third Circuit (*Bess*, 243 F (2d) 675, 678). Moreover, in the *Bess* case the Third Circuit explained that its decision in *Pearlman* v. *Comm.*, 153 F (2d) 560 (1945), should not be construed as holding that an individual beneficiary of a life insurance policy is a transferee of the proceeds, as some Courts had interpreted it:

Of course, if proceeds of insurance are made payable to the insured's estate, they are subject to the claims of his creditors, irrespective of whether they are held by the executor, (*Bank of Minden* v. *Clement*, 256 U. S. 126, 65 L. 857, 41 S. Ct. 408 (1921)), or distributed by the executor to the heirs, (*Kieferdorf* v. *Comm.*, 142 F (2d) 723 (CCA 9th, 1944), cert. den. 323 U. S. 733, 89 L. Ed. 588, 65 S. Ct. 69). Pet. Br. 21.) This is not because they are proceeds *qua* proceeds, but because they are assets of the decedent's estate the same as any other property belonging to the estate.

POINT II

Respondent Is Not A Transferee of the Cash Surrender Values

Whether respondent is a transferee of the cash surrender values of the policies as of the date of decedent's

death likewise depends upon (1) whether they were the *"proprty of a taxpayer"* during his lifetime, and (2) if so, whether respondent is a *transferee* thereof *within the* meaning of Sec. 311(a)(1).

1. ***The Cash Surrender Values Were Not the Property of the Decedent***

Petitioner argues that the "Court below erred in holding that the cash surrender values were not assets of the decedent during his lifetime." (Pet. Br. 22.)

The laws of the various states require insurance companies doing business within their borders to maintain reserves for solvency purposes so that they will be financially able to pay the death benefits when the policies mature. Reserve funds and the cash surrender values are explained in Krueger and Waggoner, "The Life Insurance Policy Contract," 1953 Edition, published by The American Society of Chartered Life Underwriters, as follows:

> "In the level premium system of life insurance the net level premium[5] must be higher than the monetary value of the annual risk during the early policy years, and the excess must be accumulated with interest to provide funds for payments of claims after the age is reached where the value of the annual risk exceeds the net level premium in the annual premium being paid. It is the necessary accumulation of these funds that makes possible non-forfeiture benefits. On surrender of a policy the insurer, being relieved of the obligation to provide death benefits

[5] "The net level premium is the annual amount which at the date of issue has a present value just equal to the then present value of insurance benefits to be provided by the policy when the present values are computed on the basis of the mortality table and rate of interest to be used for reserve valuation purposes. The actual annual premium charged the policyholder is referred to as the 'gross premium,' being the net level premium plus a level annual amount for taxes, company expenses and contingencies."

during future years where the annual value of the risk exceeds the annual net level premium, no longer needs to retain the surrendering policyholder's contributions to the funds previously accumulated for such purpose. Since the surrendering policyholder made a contribution to these funds during the period from date of issue to date of surrender, he is *equitably* entitled to a return *equal to the prorata share* of the funds actually accumulated *from premiums paid by his group of policyholders* and no longer needed to assure solvency of the company for the protection of continuing policyholders." (P. 194.) (*Italics supplied.*)

From the above it is clear that a special reserve fund is not maintained for each policyholder. MacLean on "Life Insurance", Eighth Edition, 1957, makes the following statement regarding the integrated nature of reserve funds:

"While the reserve *per policy* can be arrived at in the manner just described, it is important to realize that such a figure has no real significance as applied to an individual policyholder but is merely an *average* or *factor* to a large number of policies or to a large amount of insurance.[6] * * * It is necessary for some purposes (such as the calculation of cash surrender values) to consider the reserve for an individual policy as being the pro rata part of the total reserve for all similar policies, thus ignoring possible differences in health and probable longevity." (P. 117.) (*Italics the author's.*)

The premiums paid by the insured represent the consideration passing to the insurance company for its premise to pay the proceeds to the beneficiary upon the insured's death. The premiums do not belong to the insured; they belong to the company. Inasmuch as the

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[6] The same author prints the Commissioner's 1941 Standard Ordinary Mortality Table (C.S.O. Table), which is based on 1,000,000 lives. (P. 78). The mortality table is the basis for determination of the net level premium and the reserve.

excess of the net level premiums over the current cost of mortality, together with interest thereon, constitute the reserve fund; it follows that the reserve fund belongs to the company and not to the insured; and, *a priori*, that the cash surrender value belongs to the insurance company, inasmuch as only upon surrender of his policy is the policyholder equitably entitled to a proratable part of the reserve fund.

A few examples will demonstrate that the insured does not own the cash surrender value. If he were to borrow on the security of his policy, the amount of which would reduce the cash surrender value, he would have to pay interest on the loan. Clearly he would not have to pay interest on his own money. If he were the owner of the reserve fund of which the cash surrender value is a proratable part, he would have to pay an income tax on the interest which is accumulated in the fund. The interest, of course, belongs to the insurance company and not to the insured.

Inasmuch as there is a consideration for the promise of the insurance company to pay the proceeds to the beneficiary upon the death of the insured—the promise of the insured to pay the premiums at the time they become due; so, also, is there a consideration for the payment of the cash surrender value of the policy to the insured—the release of the company from its obligation to pay the proceeds to the beneficiary by the insured's surrendering the policy for cancellation. The insured cannot possibly own the policy and the cash surrender value at the same time.[7]

[7] Policyholder actions against life insurance companies for an accounting and distribution of surplus funds have been unsuccessful on the theory that a policyholder has only a contractual right against the company and no right to any particular assets. (*Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25, 47 (1909); *Andrews* v. *Equitable Life Assurance Society*, 124 F (2nd) 788 (CCA 7th, 1941), cert. den., 316 U. S. 682.)

The record shows that the decedent did not surrender his policies for their cash surrender values (R. 14); and, accordingly, the cash surrender values did not belong to him during his lifetime. The only asset which he owned at the time of his death was the policies under which the insurance companies were contractually obligated to pay the proceeds to the respondent.

Petitioner cites certain cases arising under the Bankruptcy Act as supporting his contention that the insured owns the cash surrender value of a life insurance policy during his lifetime; viz., *Cohen* v. *Samuels*, 245 U. S. 50, 62 L. Ed. 143, 38 S. Ct. 36 (1917), *Hiscock* v. *Mertens*, 205 U. S. 202, 211, 212, 51 L. Ed. 771, 27 S. Ct. 423 (1907), *Burlingham* v. *Crouse*, 228 U. S. 459, 469, 57 L. Ed. 920, 926, 33 S. Ct. 564 (1913). (Pet. Br. 21, 23, 49.) The Bankruptcy Act involved provided that there should devolve upon the trustee all powers with respect to property which the bankrupt himself might have exercised for his own benefit.[8] This Court held that the power to surrender a life insurance policy for its cash surrender value was a power with respect to property which vested in the trustee under the Act. There is no corresponding provision of Federal law applicable to life insurance policies, which has the effect of constituting the cash surrender values as *property of a taxpayer* within the meaning of Sec. 311.

This Court in *New York Life Ins. Co.* v. *Statham*, 93 U. S. 24, 23 L. Ed. 789 (1876), (Pet. Br. 22, 26), merely held that a forfeiture provision for non-payment of premiums should not be enforced, where the insured who resided in the South was unable to pay the premiums due to the Civil War, and that the company should pay the equitable value of the policy. The value was deter-

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[8] The Act also permitted the bankrupt to retain the policy by paying over to the trustee an amount equal to the cash surrender value.

mined to be the difference between the premium payable at the attained age of the insured when the premiums were discontinued and the premium payable at the age when the policy was issued.

U. S. v. Updike, 281 U. S. 489, 494, 74 L. Ed. 984, 50 S. Ct. 367 (1930), (Pet. Br. 30, 32), involved the question of whether the statute of limitations applicable to transferees in Sec. 280 or the general statute applicable to taxpayers in Sec. 278(d), Rev. Act of 1926, applied to a suit in equity to compel the stockholders to pay the unpaid income taxes of a dissolved corporation under the trust fund doctrine. This Court held that the limitations in Sec. 280 applied only to assessment and that Sec. 278(d) governed, as it applied to collection. Speaking of the term "taxpayer" in Sec. 278(d), the Court stated that "it puts no undue strain upon the word 'taxpayer' to bring within its meaning that person whose property, being impressed with a trust to that end, is subjected to the burden." The Court did not hold that a "transferee" within the meaning of Sec. 280 was a taxpayer, a logically the Court could not have so held, as a person cannot be a transferee of property of himself.

Petitioner cited the following cases involving Federal tax liens perfected during the insured's lifetime as authority for the proposition that the insured owns the cash surrender value of his policy during his lifetime, (*U. S. v. Hoper*, 242 F (2d) 468 (CA 7th, 1957), (Pet. Br. 10, 27, 28); *U.S. v. Behrens*, (CA 2nd, 1956), 230 F (2d) 504, cert. den. 351 U. S. 919, 100 L. Ed. 1451, 76 S. Ct. 709 (1956), (Pet. Br. 25, 27); *Knox v. Great West Life Assurance Co.*, 109 F. Supp. 208 (1952), aff'd per curiam, 212 F (2d) 784 (CA 6th, 1954), (Pet. Br. 12, 26, 39); *U. S. v. Metropolitan Life Ins. Co.*, 130 F (2d) 149, (CA 4th, 1958), (Pet. Br. 12, 26); *Kyle v. McGuirk*, 82 F (2d) 212 (CCA 3rd, 1936), (Pet. Br. 26, 39, 40); *Smith v. Donnelly*, 65 F. Supp. 415 (E. D. La., 1946), (Pet. Br. 26);

U. S. v. *Prudential Ins. Co. of America*, 54 F. Supp. 665 (E. D. Pa., 1944), (Pet. Br. 26); *U. S.* v. *Ison*, 67 F. Supp. 40 (S. D. N. Y., 1946), (Pet. Br. 12, 26); *U. S.* v. *Royce Shoe Co.*, 137 F. Supp. 786, (D. N. H., 1956), (Pet. Br. 26).; *U. S.* v. *Trout*, 46 F. Supp. 484 (S. D. Calif., 1942), (Pet. Br. 26); *Cannon* v. *Nichols*, (80 F (2d) 934 (CAA 10th, 1935), (Pet. Br. 29, 40).

Under Sec. 3670 the lien is "upon all property and rights to property," and under Sec. 3671 it arises "at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time." (Br. 2, *supra.*) It was held in the above cases that the lien attaches to the insured's interest in policies which he has the right to surrender for their cash surrender values, and that it follows the policies even though the assured assigns them or dies subsequent to the time the lien becomes effective. Property subject to a lien pases *cum onere*, (*Burton* v. *Smith*, 13 Pet. 464, 483, 10 L. Ed. 248, 257 (1839), *Michigan* v. *U. S.*, 317 U. S. 338, 87 L. Ed. 312, 314, 63 S. Ct. 302, 303 (1943); and not in the case of a life insurance policy due to the insured's ownership of the cash surrender value or due to the merger of the cash surrender value in the proceeds. In *U. S.* v. *Hoper*, *supra*, the Seventh Circuit specifically noted the distinction between an action arising under the lien provisions of the Code and Sec. 311, the transferee provision.

The income tax liability of the decedent in the instant case was not determined until 1955, which was between five and six years after his death on June 12, 1949. (R. 11, 16.) No lien could have arisen during his lifetime, as it arises only at the time the assessment list is received by the collector. (Sec. 3671.) The proceeds of insurance vested in the respondent upon the decedent's death, and clearly no lien arose retroactively in favor of the United States, either with respect to the cash surrender values or the proceeds of the policies.

It was not held that the beneficiary of a life insurance policy is a transferee of property of a taxpayer under Sec. 311(a)(1) in *U. S.* v. *Gilmore*, 222 F (2d) 167, 171 (CA 5th, 1955), (Pet. Br. 11, 29), but on the contrary that the widow beneficiary was liable in her fiduciary capacity as executrix for failing to collect from herself personally the amount of estate taxes allocable to the proceeds of insurance which she received. If she had done so, the general assets of the estate used by her to pay the estate taxes would have been available and adequate to pay the deceased's income taxes.

Although understanding that the decision of The Tax Court was "that petitioner (respondent) was subject to the income tax liability of her deceased husband with regard to the proceeds of the life insurance on the ground that she was a transferee of such proceeds and that the Estate of Milton J. Stern, Deceased, had transferred these proceeds to her," (CA Opinion, R. 17), nevertheless, the Court below passed upon respondent's liability as transferee with respect to the cash surrender values as follows:

> "The cash surrender values were not part of the proceeds of the insurance policies paid to the widow, and to hold otherwise would seem to transform plain language to the advantage of the tax-gathering authority, and to the loss of the widow. The widow did not, in any sense, receive the cash surrender values as a transferee of the estate of her deceased husband. The rights of the parties to this suit, and the rights of all parties concerned in the contract of insurance, depended entirely upon agreements executed between the insured and the insurance companies that it would pay the husband the cash surrender values, only on his demand, in lieu of paying his widow the amount of the policies after his death. If the insured did not demand such payment, the insurance companies were bound to pay the entire proceeds of the policies to the insured's wife, upon his death." (R. 25.)

The Second Circuit in *Rowen* v. *Comm.*, 215 F (2d) 641, 644, 645, 647), (Pet. Br. 25), and the Third Circuit in

U. S. v. *Bess,* 243 F (2d) 675, 676, (Pet. Br. 27), reached a contrary result which seems to be incompatible with their unqualified holding that the proceeds of insurance never belonged to the insured. After definitely holding that the proceeds always belonged to the insurance company and never at any time belonged to the insured, they, nevertheless, held that the cash surrender values belonged to the insured during his lifetime and merged at his death with the proceeds which were paid over to the beneficiary. The effect of this reasoning is that cash surrender values, which are always the property of the insured, merge with the proceeds, which are always the property of the insurance company, and still retain their identity as cash surrender values in the hands of the beneficiary. This seems to produce an incongruous result, and respondent submits that the Second and Third Circuits erred in holding that the insured owned the cash surrender values during his lifetime.

If the decision of the Third Circuit in *Pearlman* v. *Comm.*, 153 F (2d) 560, 562 (1945), be deemed to hold that the beneficiary is liable as transferee for an amount of proceeds equal to the cash surrender value of the policy, respondent submits that the Court erred. In that case the insured changed the beneficiary from his estate to his wife after he became hopelessly insolvent and thereafter continued to pay premiums while he was insolvent. The Court held that this constituted a fraud on the insured's creditors, which rendered the beneficiary liable as a transferee.

In the present case the policies were taken out between 1911 and 1935 and respondent was named beneficiary of the various policies between 1919 and 1935, which was 30 to 14 years, respectively, prior to decedent's death in 1949. (R. 18). There was no evidence or finding that the decedent took out or maintained the policies with intent to hinder, delay or defraud his creditors. (CA Opinion, R. 18). There was no evidence or finding that any pre-

miums were paid on the policies during the years decedent was held liable for income taxes or during any subsequent years prior to his death. As to such evidence, petitioner has the burden of proof (Sec. 1119(a); Resp. Br. 2.)

Petitioner devotes a portion of his brief to an argument predicated upon hypothetical facts, without any evidence whatsoever to support them, and with respect to which the petitioner himself has the burden of proof. (Pet. Br. 28; Sec. 1119(a).) He says that if decedent had honestly reported his income, he could have paid his income taxes; or, if he had honestly reported his income and failed to pay his taxes, the Government could have reached the cash surrender values of his policies during his lifetime. This is, of course, mere speculation. Moreover, it may be stated that the determination of The Tax Court was not made until more than five years after decedent's death, (R. 11, 16), when it was no longer possible for him to explain and possibly to justify his action. In any event, any understatement of income by decedent can have no bearing whatsoever upon the question of *whether respondent is liable as a transferee* for the payment of his income taxes. The only effect it can have is to increase decedent's income tax liability, and, consequently, to increase the *amount* of respondent's liability as a transferee, assuming that she is liable.

2. Respondent Is Not A Transferee Of Property Of The Decedent With Respect To The Cash Surrender Values

If the cash surrender values of the policies were not the property of the decedent during his lifetime, then respondent is not "a transferee of the property of a taxpayer," within the meaning of Sec. 311(a)(1). Nor is she "a transferee of the property of a taxpayer," if the estate is deemed to be the taxpayer, for the same reason that the cash surrender values never belonged to the estate. Only two Circuit Courts have decided that a beneficiary of a

life insurance policy is a transferee of the cash surrender values, the Second Circuit in *Rowen* v. *Comm., supra;* although holding that there was *no liability* on the part of the beneficiary, and the Third Circuit in *U. S.* v. *Bess, supra,* and also holding that there *was liability* on the part of the beneficiary. We have discussed these cases above and attempted to demonstrate that these Courts were in error in deciding that a beneficiary is a transferee of the cash surrender values. We submit that the decision of the Court below that a beneficiary is not a transferee of the cash surrender values is correct. (R. 17, 21.)

POINT III

There Is No Liability On The Part Of Respondent As Transferee

Even though respondent be deemed to be a transferee of property of the decedent taxpayer within the meaning of Sec. 311(a)(1), either as to the cash surrender values or as to the proceeds of the policies, still there is *no liability* on her part as a transferee under that section or under any other provision of Federal law. It is respondent's position that it is necessary to look to the law of Kentucky to determine her transferee liability, and that under Kentucky law she is not liable. In any event, petitioner has the burden of proving that respondent is liable as a transferee but has failed to do so.

1. Transferee Status And Transferee Liability Are Not Integrated Questions

Although petitioner admits that Sec. 311 creates no new liability on the part of a transferee of property of a taxpayer with respect to his unpaid income taxes, and that it provides merely a summary method of collecting an existing liability, (*Phillips* v. *Comm.*, 283 U. S. 589, 75 L. Ed. 1289, 51 S. Ct. 608 (1931); H. R. 1, 69th Cong., 1st Sess., CB 1939-1, Part 2, pp. 354, 371; *Leighton* v. *U. S.*,

289 U. S. 506, 77 L. Ed. 1350, 53 S. Ct. 719 (1933)); nevertheless, petitioner argues that transferee status and transferee liability are inseparable; and that transferee liability follows *ipso jure*, if one is a transferee. (Pet. Br. 34, 35.)

Sec. 311 covering income tax transferee liability and Sec. 900 covering estate tax transferee liability, (Pet. Br. 42, 45), were originally incorporated into the Rev. Act of 1926, as Secs. 280 and 316, respectively. Aside from changing the section numbers and amending the paragraph applicable to the statute of limitations, both of these sections have been reenacted without change from 1926 to 1953, with one exception.[9] In 1942 the definition of "transferee" in Sec. 900(e) was amended by adding the words: "and includes a person, who, under Sec. 827(b), is personally liable for any part of the tax." (Barton "Federal Income, Estate & Gift Tax Laws, Correlated," Eighth Ed., pp. 387, 532; Ninth Ed. pp. 562, 1044; Tenth Ed., pp. 644, 767; Eleventh Ed., pp. 389, 522; where the various laws are arranged in parallel columns.)

Reference to Sec. 827(b) discloses that among other persons, a beneficiary of life insurance proceeds, which are includible in the gross estate under Sec. 811(g), is made "personally liable for such tax" to the extent of the value of the proceeds as of the date of the decedent's death." (Pet. Br. 44). The purpose of the 1942 amendment of Sec. 900(e) was not to create a liability on the part of a beneficiary of a life insurance policy for the payment of the estate tax but to subject to the summary process of assessment, collection and payment a beneficiary *who already was personally liable for the tax*.[10]

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[9] Sec. 311(a) has been reenacted in Sec. 6902(a), I.R.C. of 1954, without change.

[10] The forerunner of Sec. 827(b) of the 1939 Code was Sec. 409 of the Rev. Act of 1918, which made a beneficiary of a life insurance policy "personally liable for such tax." Sec. 402(f) of

Sec. 827(b) does not make all beneficiaries of life insurance policies personally liable for the tax, and, a *priori*, Sec. 900(e) does not include all beneficiaries of life insurance policies. It is only beneficiaries of policies the proceeds of which are includible in the gross estate, who are covered by Sec. 827(b) and Sec. 900(e). Beneficiaries of policies not falling within the premium payment or incidents of ownership tests set out in Sec. 811(g)(2) are not liable for any part of the estate tax, and, consequently, they are not within the definition of "transferee" in Sec. 900(e), even since the 1942 amendment.

If Congress had deemed the definition of "transferee" in Sec. 900(e) to be broad enough to include the beneficiary of a life insurance policy, there would have been no need to enlarge the definition in the 1942 amendment. The failure to make a similar amendment to Sec. 311(f) can only be interpreted as an indication of Congressional intent not to subject a beneficiary of a life insurance policy to transferee liability with respect to income taxes. Even then it would have been necessary to create the liability by some provision other than Sec. 311(a)(1).

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that Act provided for the first time that proceeds of insurance should be includible in the gross estate, except there was an exemption of $40,000 in respect of policies made payable to all beneficiaries other than the executor. The beneficiary continued to be personally liable for the tax in every Revenue Act subsequent to 1918; however, it was not until 1942, when the definition of transferree in Sec. 900(e) of the 1939 Code was amended to include a beneficiary, that Congress provided that a beneficiary should be subject to the summary process provided for in Sec. 900(a)(1). (Barton "Federal Income, Estate and Gift Tax Laws, Correlated," Eighth Ed., pp. 490, 491, 530, 531; Ninth Ed., pp. 968, 969, 1002, 1003, 1046, 1047.) This seems to demonstrate conclusively that Sec. 900(a)(1) does not create a liability with respect to estate taxes; and, *a priori*, that Sec. 311(a)(1) does not create a liability with respect to income taxes. In fact there is no provision in the 1939 Code creating a personal liability of a beneficiary for income taxes corresponding to Sec. 827(b) creating a personal liability of a beneficiary for estate taxes.

2. *Income Tax Liability Is Governed By State Law*

Petitioner says that the holding of the Second Circuit in *Rowen* v. *Comm.*, 215 F. (2d) 641, 647, "that the liability of a transferee should be limited by State law is, we submit, erroneous." (Pet. Br. 29.) The language of that Court clearly shows that it did not hold that the liability should be *limited* by State law:

> "The conclusion just reached confronts us with the second question posed above. Granted that the appellants are transferees as to the cash surrender values of the policies, are they under 'liability, at law or in equity' for their decedent's unpaid income taxes? In determining this question we hold that local State law governs. For neither by Section 311 nor by any other Federal statute is *liability* of such a transferee defined. Granted that Congress by specific legislation might have preempted the field, it has not chosen to do so. As a result, when Congress extended its general tax collection procedure to the 'liability' of a transferee, it necessarily must have intended that the existence of liability should be determined by State law. Other than State law, there is no source to which we may look for pertinent authority." (*Italics the Court's*).

To the same effect are *Harwood* v. *Eaton*, 68 F. (2d) 12 (CCA 2nd, 1933), cert. den. 292 U. S. 636, 78 L. Ed. 1489, 54 S. Ct. 715 (1934); *Boltz* v. *Helvering*, 134 F (2d) 538 (CCA 8th, 1943); *U. S.* v. *Truax*, 223 F (2d) 229, 231 (CA 5th, 1955; Mertens "Law of Federal Income Taxation," Vol. 9, Ch. 53, §53.05.

The Third Circuit in *Pearlman* v. *Comm.*, 153 F (2d) 560, 562, and in *U. S.* v. *Bess*, 243 F (2d) 675, 677, held that the liability of a transferee under Sec. 311(a)(1) is to be determined by "general law as declared by Federal courts" and not by reference to the law of the State. The fact that the Court stated that liability was determinable under "general law" clearly indicates that the Court did not consider that transferee liability was created under

Sec. 311(a)(1) or by any other Federal statute. The Court necessarily had in mind the common law as contradistinguished from statutory law.

It has been well settled that there is no Federal common law. In *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64, 78, 82 L. Ed. 1188, 1194, 58 S. Ct. 817, 822 (1938), this Court said:

> "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest Court in a decision is not a matter of Federal concern. *There is no Federal general common law.*"[11] (*Italics supplied.*)

To the same effect, see 15 *C. J. S.* 630. In 15 *C. J. S.* 616 it is stated:

> "Equitable principles and rules, as administered in the English court of chancery, in so far as applicable to our conditions, have been adopted as part of our common or unwritten law."

The rule is stated in Title 28, Sec. 1652, U. S. C., Act of June 25, 1948, c. 646, 62 Stat. 944, as follows:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in the Courts of the United States in cases where they apply."

Respondent submits that the determination of the liability of the respondent as a transferee of the property

[11] Petitioner's note (Br. 36), regarding the Court's reference to "Federal common law," involved a controversy between States, where the law of neither State was applicable. Moreover, it should be observed that the Court enclosed the above words in quotation marks, possibly indicating that they were not used in the sense that there is a Federal common law. This would seem to be a reasonable assumption in view of the Court's express holding in the *Erie Railroad* case that there is no federal common law.

of the decedent taxpayer is governed by Kentucky law, inasmuch as there is no Federal law fixing her liability as a transferee.

3. *Respondent Has No Transferee Liability Under Kentucky Law*

Petitioner's entire argument with respect to the application of State law seems to be that State law cannot *limit* the liability of a transferee of property of a taxpayer with respect to income taxes, whereas, the question is whether State law *fixes* the liability in the absence of any governing Federal law. So the question presented is whether respondent is liable as a transferee under Kentucky law.

Sec. 297.140, Kentucky Revised Statutes (Pet. Br. 46, 47), provides that a policy of insurance for the benefit of a married woman "shall inure to her separate use and benefit * * * independently of her husband or his creditors," subject to the provision that an amount equal to any premiums paid by any person with intent to defraud his creditors, with interest thereon, shall inure to their benefit; and Sec. 297.150 provides that when a policy of insurance is taken out in favor of some person other than the one taking it out, "the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to the proceeds against the creditors and representatives of the person effecting the same," subject to the further provision that the amount of any premiums paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds.[12]

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[12] Both of these sections originated as far back as 1893, Sec. 297.140 as Sec. 654 and Sec. 297.150 as Sec. 655. (Carroll's Ky. Stats. (1936) Ed. (1893, c. 243, p. 1257, amending 1893, c. 171, p. 612, Sec. 117; 1893, c. 171, p. 612, Sec. 118.))

In *National Life & Accident Ins. Co.* v. *Walker*, 246 SW (2d) 139, 140, the Court of Appeals of Kentucky stated:

> "Both of the subsections of KRS 297.140 were enacted for the protection of the beneficiary, particularly the family of the insured. The intent of subsection (1) is to provide that the proceeds payable to a married woman shall be *her separate estate* free from debts of her husband, the insured." (*Italics ours.*)

In *Park's Exs.* v. *Parks*, 288 Ky. 435, 440, 441, 156 S W (2d) 480, 483, in a suit by the creditors and executors of the insured to have the Court declare that the proceeds payable to the insured's wife as beneficiary were the proceeds of the estate, the Court of Appeals of Kentucky said:

> "However, calling the right of the beneficiary as only an expectancy is not altogether accurate. Technically it may be regarded as something more. It is a right subject to be defeated by the exercise of the reserved power or the lapsing of the policy. Couch, Cyc. of Ins. Law, Sec 308; 29 Am. Jur. Ins., Secs. 1276, 1315. As stated in Martinelli Cometti, 133 Misc. 810, 234 N. Y. S. 389, 391:
>
> > 'There is no question that an existing beneficiary in the policy of insurance is protected until the conditions imposed by the contract are complied with.'"

It is well settled in Kentucky that under Sec. 297.150, formerly Sec. 655 of Kentucky Statutes, the executor of a named beneficiary who predeceases the insured has a right to the proceeds in the absence of a change in the beneficiary by the insured. (*Neal* v. *Shirley*, 137 Ky. 818, 127 SW 47; *Buckler* v. *Supreme Council*, 143 Ky. 618, 136 SW 1006; *Vaughan* v. *Modern Brotherhood*, 149 Ky. 587, 149 SW 937; *Hall* v. *Ayer*, 105 SW 911, 32 Ky. L. Rep. 291; *Bradley* v. *Bradley's Estate*, 198 SW 905, 907.)

The Sixth Circuit in the instant case discussed the Kentucky law but did not need to reply upon it, in view of the Court's holding that the insured owned neither the cash surrender values nor the proceeds of the policies, and that there was no transfer of property of the decedent taxpayer to the respondent. (R. 22-25.)

Art. 7, Sec. 166, of the New York Insurance Law, which is similar to Sec. 297.150 of the Kentucky Revised Statutes, was construed by the Second Circuit in *Rowen* v. *Comm.*, 215 F. (2d) 641, 649,[13] to declare "a substantive right of the beneficiary to the proceeds and his non-liability to creditors," and the Court rejected the Commissioner's contention that it was an exemption statute. Title 56, Sec. 56-905 of the Georgia Code, Annotated, also similar to Sec. 297.150 of the Kentucky Revised Statutes and Art. 7, Sec. 166, of the New York Insurance Law, was construed by the Fifth Circuit in *U. S.* v. *Truax*, 283 F (2d) 229, 233[14] to create a substantive right in the beneficiary and that it was not an exemption statute.[15] In *U. S.* v. *Ress*, 273 F (2d) 675, 677, the Third Circuit held that under Secs. 28 and 29, Chapter 34, Title 17, of the New Jersey Revised Statutes,[16] the language of which is very similar to the language of Secs. 297.140 and 297.150 of the Kentucky Revised Statutes, the widow beneficiary of the insured had a "vested interest" in the proceeds. The Second Circuit in the *Rowen* case and the Fifth Circuit

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[13] Art. 7, Sec. 166, is printed in the margin of the opinion at p. 648.

[14] Title 56, Sec. 56-905, is printed in the margin of the opinion at p. 232.

[15] The decisions of the Second and Fifth Circuits are in effect a recognition of the proposition that a law of the State where the insurance is written is as much a part of the policy as if it were incorporated therein. (Bank of Washington v. Hume, 128 U. S. 195; 29 Am Jur. 197.)

[16] Secs. 28 and 29 are printed in the margin of the opinion at p. 677.

in the *Truax* case held that the beneficiary was not liable as a transferee for the unpaid income taxes of the insured; whereas, the Third Circuit in the *Bess* case held that the widow beneficiary was liable, because transferee liability was determinable under Federal instead of State law.

The question actually resolves itself into the ownership of property, in this case the ownership of the cash surrender values or the proceeds of insurance of the policies on decedent's life. As to the ownership of property, the Federal courts always hold that State law governs. (*Tyler* v. *U. S.*, 281 U. S. 497, 74 L. Ed. 991, 50 S. Ct. 376 (1930); *Warburton* v. *White*, 176 U. S. 484, 496, 44 L. Ed. 991, 50 S. Ct. 376 (1900); *Helvering* v. *Stuart*, 317 U. S. 154, 161, 162, 87 L. Ed. 154, 63 S. Ct. 140 (1942); *Blair* v. *Comm.*, 300 U. S. 5, 9, 81 L. Ed. 465, 57 S. Ct. 330 (1936).)

Respondent, respectfully submits that under Kentucky law the decedent did not own either the cash surrender values or the proceeeds of the policies; that the respondent owned the proceeds; and that she was not liable at law or in equity as a transferee of property of the deceased taxpayer within the meaning of Sec. 311.

4. *Petitioner Has The Burden Of Proving Respondent's Liability As A Transferee*

Although respondent has argued that there is no Federal or State law fixing or determining her liability as a transferee of the proceeds or the cash surrender values of the policies, the burden of proof legally is upon the petitioner to show that respondent is liable as a transferee. Sec. 1119(a) of the 1939 Code specifically provides that in cases before The Tax Court the burden to show that the petitioner before that Court is liable as a transferee of property of a taxpayer is upon the Commissioner. (Res. Br. 2, *supra.*) Accordingly, it is not incumbent upon respondent to show that *she is not liable;* but on the con-

trary the burden falls upon the petitioner herein to prove that *respondent is liable* as a transferee of property of the decedent. Respondent submits that the petitioner has failed to cite any Federal or State law fixing or determining her liability as a transferee with respect to the proceeds or the cash surrender values of the policies of insurance.

POINT IV

Questions Not Presented To Or Decided By The Tax Court Are Not Properly Before This Court

The only question before The Tax Court was whether respondent was liable as a transferee of the *estate of decedent* with respect to the *proceeds* of the policies of insurance. (Deficiency letter, R. 4, 5; Petition, R. 3, 4; Answer, R. 6-8; Reply, R. 9-11); and that is the only question decided by The Tax Court. (R. 15, 16.)

The only question presented to the Court of Appeals below was the same, and the Court of Appeals understood that to be the question. (R. 17, 18.)

This Court has held that a question not presented to The Tax Court should not be passed upon by a Court of Appeals for the logical reason that a litigant is entitled to know the basis of the claim against him (*General Utilities Operating Company* v. *Helvering*, 296 U. S. 200, 80 L. Ed. 154, 56 S. Ct. 185) (1935); and that a question not raised before The Tax Court and the Court of Appeals will not be considered by this Court on certiorari. (*Helvering* v. *Tex Penn Oil Co.*, 300 U. S. 481, 81 L. Ed. 755, 57 S. Ct. 569 (1937); *Helvering* v. *Cement Investors*, 316 U. S. 527; 86 L. Ed. 1649, 62 S. Ct. 1125) (1942).

Respondent submits that the only question properly before this Court is her liability as a transferee of the estate of the decedent with respect to the proceeds of insurance.

CONCLUSION

For the foregoing reasons the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 311

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

JEAN F. STERN, *Transferee*.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF THE LIFE INSURANCE ASSOCIATION OF AMERICA

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since this Court has held and the Government has conceded that there are many types of transactions to which the estate tax applies which are not "transfers" at death which can be reached under the trust fund doctrine.

Congress has repeatedly enacted legislation imposing liability on a life insurance beneficiary in certain cases for the *estate tax* obligations of a decedent, but it has never seen fit to impose such liability for the *income tax* obligations of a decedent. Congress has specifically recognized in other legislation that there is a class of persons (including life insurance beneficiaries) who are liable as transferees for the estate tax obligations of a decedent in addition to those persons who are liable as transferees for the income tax obligations of a decedent.

(2) The cash surrender value of a policy at date of death is not transferred to the beneficiary as a part of the proceeds of the policy. Provisions permitting a policyholder to surrender his policy for a cash value first appeared in level premium policies long after that form of policy was developed. Such values have nothing to do with the death benefit payable to the beneficiary. No fund is maintained by an insurer in connection with a particular policy which corresponds to the non-forfeiture values provided in the policy. A cash surrender option is ordinarily only one of several contract options available to the insured when he ceases to pay premiums. Until that option is exercised there is no definite ascertainable amount owing by the insurer to the insured which can be considered the "property of the" insured. The cash surrender option may be elected only by the insured and the cash value becomes payable only upon surrender of the

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BRIEF AMICUS CURIAE ON BEHALF OF THE LIFE INSURANCE ASSOCIATION OF AMERICA

STATEMENT OF INTEREST

The Life Insurance Association of America is composed of 118 life insurance companies which have written 86 percent of the legal reserve life insurance in force in the United States today. This case involves the issue of the liability of the beneficiary of a life insurance policy for Federal income taxes owed by

the insured which were determined and assessed after the death of the insured.

The interest of the Association in the case arises from such fundamental questions necessarily involved in this issue as the nature of the property interest which an insured has in the insurance contract during his lifetime, the legal status of the reserves and assets of a life insurance company and the relationship of cash surrender values thereto, and the question of what happens to these various rights at the time of death. The disposition of these questions in this case might also have serious implications in other areas, such as whether the statute of wills could or might be applied to life insurance contracts; whether the rights of creditors other than the Government could be enforced against a beneficiary under the circumstances of this case despite well-established principles of law to the contrary, and whether an insurance company is a trustee or custodian of a fund belonging to its policyholders individually. These are questions of fundamental importance to the life insurance companies.

The Life Insurance Association of America submits that a beneficiary has no liability to the Government under the circumstances of this case and its brief therefore supports the position of the respondent. Written consents of both counsel for the respondent and the Solicitor General to the filing of this brief are being filed simultaneously herewith.

SUMMARY OF ARGUMENT

There is no specific statute imposing liability on a life insurance beneficiary for the income tax obligations of an insured. The Government relies on a liabil-

ity in equity under the "trust fund doctrine" which is said to arise where there has been a "transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts." Govt. Brief, p. 10. Consequently, unless there was a transfer of assets from the the insured to the beneficiary there can be no liability. The Government contends that at death the proceeds of the policies—or alternatively, the cash surrender values—were transferred from the insured to the beneficiary. Neither contention is sound.

(1) Under well-settled principles of insurance law, payment of the proceeds of a policy at death does not represent a transfer of property of the insured to the beneficiary. It is incorrect to view payment of the contractual death benefits as the distribution of a fund accumulated during the lifetime of the insured and owned by him up to his death. The insurance company does maintain reserves as required by law to assure solvency. These reserves, however, are the property of the company, not the insured, and no reserve is maintained with respect to a particular policy. The rights of the insured and those of the beneficiary are purely contractual. The taxpayer in the instant case at no time had a right to the death proceeds of the policies. Accordingly, payment of those proceeds by the insurance companies to the beneficiary could in no way involve a transfer of the taxpayer's property to the beneficiary.

Cases upholding the imposition of an estate tax on the proceeds of life insurance paid to a beneficiary do not establish that there is a transfer of property at death within the meaning of the trust fund doctrine,

policy. This contract option terminates upon the insured's death, and neither the option nor the cash surrender value itself is transferred to the beneficiary.

ARGUMENT

This proceeding was commenced by the issuance of a statutory notice by the Commissioner of Internal Revenue under Section 311 of the Internal Revenue Code of 1939 (now Sec. 6901 Internal Revenue Code of 1954). The Commissioner asserts that respondent, as the designated beneficiary of various insurance policies on the life of her deceased husband, is liable as transferee for certain income tax obligations of her husband determined after his death.

It is well-settled—as acknowledged by the Government in its brief—that the enactment of Section 311 (originally as Section 280 of the Revenue Act of 1926) did not create any new liability; it is *purely procedural* in that it merely authorizes the Commissioner to utilize against a transferee of property of a taxpayer having a "liability, at law or in equity" for the obligations of his transferor the same summary procedures for the collection of income taxes as are available against the taxpayer himself. Govt. Brief, pp. 9 and 35; also see *Phillips-Jones Corp. v. Parmley,* 302 U. S. 233 (1937) and page 43 of the Report of the Conference Committee on the Revenue Act of 1926 (69th Congress, 1st Session, H. R. 356).

There is no specific statute imposing liability on a life insurance beneficiary for the income tax obligations of the person whose life is insured. The Government relies on the so-called trust fund doctrine, which is said to impose a liability in equity where there has been a "transfer of assets without adequate

consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts." Govt. Brief, pp. 5, 10, 35-36.[1]

There is no evidence that the insured was insolvent at any time prior to his death (Govt. Petition for Certiorari, p. 3; also see R. 18),[2] and respondent was designated as beneficiary of all the policies long before any of the taxable years involved (R. 12, 13). The Government contends, however, that the proceeds of the policies (or, alternatively, the cash surrender values) were transferred to the beneficiary from the insured upon his death, and that since the assets of his estate turned out to be insufficient to satisfy his debts, the beneficiary is liable to the extent of such proceeds (or an amount equal to the cash surrender values) for the income tax obligations of the insured. Govt. Brief, pp. 5-6, 20, 22.

It is the position of the Life Insurance Association of America that in the light of the nature of the insurance contract, and well-established legal principles with respect thereto, the Government is in error

[1] The Government contends that this doctrine applies in the present case despite (a) the provision in section 1652 of Title 28 of the United States Code that "the laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply," and (b) the holding of the court below that under the law of Kentucky there is no liability of a beneficiary to creditors of the insured for obligations existing at his death (R. 19). As the issue of whether the Government must look to state law to establish liability will undoubtedly be argued at length by the parties in their respective briefs, it is not discussed here.

[2] The burden of proof of establishing liability in a proceeding under Section 311 is on the Government. Section 1119(a), Internal Revenue Code of 1939.

in asserting that there is a transfer of either the proceeds or the cash surrender value of a policy from the insured to a designated beneficiary so as to create an equitable liability on the part of the beneficiary to meet the income tax obligations of the insured.

I. THE PROCEEDS ARE NOT TRANSFERRED FROM THE INSURED TO THE BENEFICIARY

A. Under General Principles of Insurance Law, Payment of the Death Benefit Involves No Transfer of Property of the Insured.

When a policyholder purchases a life insurance contract, he receives a contract obligation from the insurance company that, if the required premiums are paid, the insurance company will pay a predetermined amount to a designated beneficiary upon the death of the insured. The amount of the premiums required to be paid by each class of policyholders is originally determined according to age, assumed mortality, anticipated expenses, and anticipated return on investments of the insurance company. The obligation of the insurance company, however, is fixed by the contract at the time it is entered into and is in no wise dependent upon the insurer's subsequent actual experience with respect to mortality, expenses or return on investments.

It is incorrect, therefore, to view a life insurance policyholder as the owner of a fund, which is being accumulated by the insurer in connection with his particular policy and is eventually paid as part of the benefits provided. There is no such fund. A brief review of the historical development of the life insurance contract will demonstrate this point.

The earliest form of life insurance was "assessment insurance" under which each policyholder was as-

sessed each year an amount, the same for all ages, sufficient to pay death claims and expenses for the year. The "assessment plan" proved unsatisfactory because the younger policyholders were reluctant to pay the high cost of insuring the older ones.

To meet this objection, "yearly renewable term insurance" was devised. Under this plan, each policyholder was required to pay each year an amount (premium) which increased with his age. As in the case of "assessment insurance", the amount so charged was based on what was needed to pay death claims and expenses for the year. But the "yearly renewable term plan" also proved unsatisfactory because the older policyholders eventually found the premiums prohibitive.

To overcome the difficulties of both of these plans, the "level premium plan" was developed. Under this plan, the amount of the premium to be paid each year is determined when the policy is written and remains unchanged thereafter. In the early years of the policy the premium is larger than it would be under a yearly renewable term insurance plan, while in the later years it is much smaller. As in the case of assessment or yearly renewable term insurance, the premiums are used to pay claims and expenses, but the aggregate of the excess premiums in the early years for a large group of policies is a measure of the company's contingent liability for that portion of the future claims which cannot be met from the future premiums alone. Computation of premiums is, of course, based on actuarial averaging. Some persons insured will die prematurely and others will live beyond normal life expectancy. Thus for any given class of persons insured a sufficient amount must be collected from all persons

within the class to meet both current and future liabilities. The solvency of the company depends upon th maintenance of aggregate reserves sufficient to cove this aggregate future liability.

Reserves on life insurance policies issued under th level premium plan were maintained by insurers fro the outset, first by voluntary action of the compani and later under various state regulatory laws, the firs of which was enacted in Massachusetts in 1854.[3] Th laws regulating life insurance reserves were designe solely to assure solvency of the insurers and did no deal with, or affect in any way, the contractual obliga tions of the insurers or the rights of the policyholders

Accordingly, when the insurer pays a death benefi under a policy, it does not pay a reserve fund main tained under the particular policy plus an additiona amount to make up the balance of the benefit payable it merely satisfies its contract obligations to pay the amount specified in the policy. *The payment of the death benefit involves no transfer of the policyholder's property.* This is so because the policyholder has no property interest in the reserves or assets of the insurer corporation.[4]

These principles have been frequently recognized and applied by the Federal courts. For example, the courts have consistently rejected policyholder actions for an accounting and distribution of the surplus funds of an insurance company,[5] on the ground that the

[3] See *Reports and Statements on Nonforfeiture Benefits,* published by authority of the National Association of Insurance Commissioners, 1942, p. 19.

[4] Krueger and Waggoner, *The Life Insurance Policy Contract,* 1953, p. 83.

rights of a policyholder are purely contractual and he has no right to any particular assets of the corporation. *Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25, 47 (1909); *Andrews* v. *Equitable Life Assurance Society*, 124 F. 2d 788 (7th Cir., 1941), certiorari denied, 316 U. S. 682.

Mr. Justice Vinson said in *John Hancock Mutual Life Insurance Company* v. *Helvering*, 128 F. 2d 745 (D. C. Cir., 1942), an estate tax collection case:

> "There is much difference between the insurance rights left for X and the willing of a lot to Y. While Y is transferred what decedent had, X receives something much different than decedent ever, or could have had."

In accordance with these principles the Courts of Appeals, in contrast with the Tax Court, have uniformly held that as to the proceeds of a life insurance policy a beneficiary is not "a transferee of property of a taxpayer" for income tax collection purposes within the meaning of Section 311, for the reason that "in no sense were the proceeds ever property of the decedent taxpayer." *Tyson* v. *Commissioner*, 212 F. 2d 16 (6th Cir., 1954); *Rowen* v. *Commissioner*, 215 F. 2d 641 (2d Cir., 1954); *United States* v. *New*, 217 F. 2d 166 (7th Cir., 1954); *United States* v. *Bess*, 243 F. 2d 675 (3rd Cir., 1957), certiorari granted October 28, 1957. See also *United States* v. *Truax*, 223 F. 2d 229 (5th Cir., 1955).[5]

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[5] The designation of a beneficiary in an insurance contract has been held not to violate the Statute of Wills because the right of the beneficiary to enforce is based upon a contractual obligation and not on an interest in the property of the decedent. *Cors* v. *State Mutual Life Assurance Co.*, 196 F. 2d 625 (6th Cir., 1952). Also see *Mutual Benefit Life Insurance Co.* v. *Ellis*, 125 F. 2d 127

The Government seeks to escape the force of this reasoning by contending that, since the policyholder could have changed the beneficiary to his estate, his failure to do so constituted a transfer of the proceeds to the respondent. Govt. Brief, p. 5. This, we think, does violence to the trust fund doctrine and to the language and purpose of Section 311. The purpose of Section 311 was to enable the Government, in a properly applicable case, to invoke the trust fund doctrine to follow "property of a taxpayer" into the hands of a transferee where the taxpayer transferred such property while insolvent, and thereby to prevent prejudice to the Government as a result of the transfer. As this Court long ago pointed out in *Central Bank of Washington* v. *Hume*, 128 U. S. 195, 203-204 (1888), in discussing 13 Eliz. c. 5, which formed the basis of the trust fund doctrine:

> "The object of the statute of Elizabeth was to prevent debtors from dealing with their property in any way to the prejudice of their creditors; but

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(2d Cir., 1942), and other cases cited at 94 C. J. S. Wills § 148. In *In re Killien's Estate*, 178 Wash. 335, 35 Pac. 2d 11 (1934), the Supreme Court of Washington, in a very comprehensive opinion reviewing numerous decisions to the same effect in other states, held that in the absence of a specific provision (as in the Federal estate tax statute) imposing a tax on life insurance proceeds, a general inheritance tax statute applying to "all property passing by will or inheritance or by deed, grant, or gift in contemplation of, or intended to take effect at death," did not apply to insurance proceeds payable to a designated beneficiary even though there were contract provisions for the right to change the beneficiary and surrender of the insurance for its cash surrender value, since the right of the beneficiary to receive the proceeds arose under the contract of insurance *rather than by virtue of a transfer at death of property of the insured.* That imposition of the Federal estate tax on insurance proceeds is not based upon the assumption that there is a transfer of property at death from the insured to the beneficiary, see pp. 12-14, *infra*.

dealing with that which creditors, irrespective of such dealing, could not have touched, is within neither the letter nor the spirit of the statute."

In the case at bar, *the taxpayer never had a right to the proceeds of the policies.* Hence the Government never had a right to obtain these proceeds from the taxpayer in payment of his delinquent taxes.[6]

B. Congress Intended to Make the Beneficiary of Life Insurance Liable for Estate Taxes, But Not for Income Taxes

The Government devotes a major part of its brief to an examination of the *estate tax* statute and the cases decided thereunder in an effort to establish the proposition that where the insured has retained the right until his death to change the beneficiary of his life insurance policy, there is a transfer of the proceeds from the insured to the beneficiary upon the insured's death. Govt. Brief, pp. 13 to 19.

The Government relies in particular on the case of *Chase National Bank* v. *United States,* 278 U. S. 327 (1929), in which the Court upheld the imposition of the estate tax on the proceeds of life insurance poli-

[6] In what appear to be the only cases in the Federal courts not previously referred to, involving attempts by creditors to reach the proceeds of life insurance in the hands of beneficiaries under the principles of the trust fund doctrine, it has been uniformly held that creditors can do so only where it can be shown that the insured has dealt with the policies to the prejudice of his creditors during insolvency prior to death. *Spiro State Bank* v. *Bankers' National Life Ins. Co.,* 69 F. 2d 185 (8th Cir., 1934); *In re Bear,* Fed. Cas. No. 1178 (S. D. Miss., 1875); *Aetna National Bank* v. *Manhattan Life Ins. Co.,* 24 Fed. 769 (S. D. N. Y., 1885); *Aetna National Bank* v. *U. S. Life Ins. Co.,* 24 Fed. 770 (S. D. N. Y. 1885); *Harriman National Bank* v. *Huiet,* 244 Fed. 216 (E. D. S. C., 1916) and *Navassa Guano Co.* v. *Cockfield,* 253 Fed. 883 (4th Cir., 1918). Also see *Pauling* v. *Pauling,* 159 F. 2d 531 (8th Cir., 1947) (based on a state statute identical in principle with the statute of 13 Eliz. c. 5).

cies against the contention that the tax was unconstitutional because it had not been apportioned ~~as~~ is required of a direct tax on property. The Government lays great stress on its contention that imposition of the tax was sustained on the ground that the estate tax is a tax on "transfers." In *New York Trust Company, et al.* v. *Eisner,* 256 U. S. 345 (1921) and *Knowlton* v. *Moore,* 178 U. S. 41 (1900), the Court had said that an estate or legacy tax is imposed on the "power to transmit or the transmission or receipt of property by death", and it is clearly in this sense that the Court upheld the power of Congress to subject life insurance proceeds to the estate tax in the *Chase National Bank* case. There can be no dispute that the beneficiary receives the proceeds on account of the death of the insured, but this is not to say that the proceeds pass out of the insured to the beneficiary at such time. In *Tyler* v. *United States,* 281 U. S. 497 (1930), the Court said that the question for estate tax purposes is not "whether there has been in the strict sense of that word, a 'transfer' of the property by the death of the decedent or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result (which Congress may call a transfer tax, a death duty, or anything else it sees fit), to be measured in whole or in part by the value of such rights."

The estate tax applies to an *inter vivos* transfer of property in trust where the decedent has reserved the right up to the date of his death to revoke the trust;[7]

[7] Section 811(d)(1), Internal Revenue Code of 1939. This was sustained in *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339 (1929).

but this Court pointed out in *Jones* v. *Clifton*, 101 U. S. 225 (1880), that it was well-settled that in the absence of insolvency or actual fraud at the time such an interest is created, property cannot be reached by a creditor merely because in creating the interest the debtor retained the power of revocation. The estate tax also applies to property in which the decedent held a joint interest at death;[8] yet the Government stated without equivocation in its Petition for Certiorari in this case that property jointly held by the taxpayer with his wife at the date of death cannot be reached in the hands of his wife under Section 311 for the payment of taxes (Govt. Petition for Certiorari, p. 3).[9] It is thus clear that the estate tax applies to many types of transactions which are not "transfers of property" at death within the meaning of the trust fund doctrine.

It is also clear from the legislative history of the procedures established for collection of the estate tax that it has never been assumed by the Congress that (in the absence of specific statute) the beneficiary of a life insurance policy has any liability to creditors of the insured for debts which cannot be met out of his estate. Congress, for the first time, in the Revenue Act of 1918, imposed an estate tax on the proceeds of life insurance made payable to designated benefici-

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[8] Section 811(e), Internal Revenue Code of 1939. This was sustained in *Tyler* v. *United States*, 281 U. S. 497 (1930).

[9] See *Irvine* v. *Helvering*, 99 F. 2d 265 (8th Cir., 1938); *Tooley* v. *Commissioner*, 121 F. 2d 350 (9th Cir., 1941); *Parker* v. *Commissioner*, 122 F. 2d 230 (9th Cir., 1941); *Fecarotta* v. *U. S.*, 154 F. Supp. 592 (D. Ariz., 1956). Also see *DeSalvo* v. *Commissioner*, 14 T. C. M. 249, 1955 P-H T. C. Memo Dec., ¶ 55,076, stating that the Commissioner has now abandoned an earlier view to the contrary.

aries under policies taken out by the decedent upon his own life (*Cf.* Section 402(f), Revenue Act of 1918 and Section 202, Revenue Act of 1916). At the same time it provided in Section 409 of the Revenue Act of 1918 that for *estate tax* purposes:

> "If (a) the decedent makes a transfer of, or creates a trust with respect to, any property in contemplation of or intended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for a fair consideration in money or money's worth) or (b) *if insurance passes under a contract executed by the decedent in favor of a specific beneficiary,* and if in either case the tax in respect thereto is not paid when due, then the transferee, trustee or *beneficiary shall be personally liable for such tax,* and such property, to the extent of the decedent's interest therein at the time of such transfer, or to the extent of such beneficiary's interest under such contract of insurance, shall be subject to a like lien equal to the amount of such tax." (Emphasis added)[10]

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[10] The Government contends that the Court below, the Court of Appeals for the Second Circuit in *Rowen* v. *Commissioner,* 215 F. 2d 641 (1954), the Court of Appeals for the Seventh Circuit in *United States* v. *New,* 217 F. 2d 166 (1954), and the Court of Appeals for the Third Circuit in *United States* v. *Bess,* 243 F. 2d 675 (1957), certiorari granted October 28, 1957, are all incorrect in their conclusion that "in no sense were the proceeds ever property of the decedent taxpayer"; it should be noted, however, that in enacting Section 409 of the Revenue Act of 1918 Congress did not consider the words imposing liability on the recipient of property "to the extent of the decedent's interest therein at the time of such transfer" as adequate to cover the proceeds of life insurance, since it found it necessary to add the words "or to the extent of such beneficiary's interest under such contract of insurance." See *John Hancock Mutual Life Insurance Co.* v. *Helvering,* 128 F. 2d 745 (D. C. Cir., 1942).

If the Government were right that a beneficiary of a policy on the life of the decedent (or any person receiving property subject to the estate tax) has always been liable under the trust fund doctrine to the creditors of the decedent, including the Government, for the debts of the decedent's estate, there would have been no necessity for a specific statute imposing such liability on the beneficiary for the estate tax obligations of the decedent's estate. Yet the provision making a beneficiary personally liable for the *estate tax* liability of the insured's estate has been retained in every revenue act since 1918 up through 1954.[11] In fact, although the language has been considerably changed three times since 1918, there is nothing to indicate that Congress ever considered such statute unnecessary.[12]

Even the enactment of a specific statute imposing liability on a life insurance beneficiary for estate tax was not deemed adequate by the Congress to enable the Commissioner to utilize against beneficiaries the summary collection procedures available against

[11] Section 409, Revenue Act of 1921; Section 315(b), Revenue Acts of 1924, 1926, amended by Section 803(c), Revenue Act of 1932; Section 827(b), Internal Revenue Code of 1939, amended by Section 411(a), Revenue Act of 1942; Section 6324(a)(2), Internal Revenue Code of 1954. As last amended, Section 827(b) of the Internal Revenue Code of 1939 provided that "if the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, non-exercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under Section 811(b), (c), (d), (e), (f), or (g), to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. * * *"

[12] Section 315(b), Revenue Act of 1924; Section 803(c), Revenue Act of 1932; Section 411(a), Revenue Act of 1942 and Section 6324(a)(2), Internal Revenue Code of 1954.

transferees. In 1926, Congress inserted in the statute what subsequently became Section 900 of the Internal Revenue Code of 1939 (Section 316 of the Revenue Act of 1926) providing summary collection procedures against transferees for the collection of estate taxes similar to that provided in Section 311 for the collection of income taxes. Both Section 311(f) and Section 900(e) originally defined the term "transferee" to include "heir, legatee, devisee and distributee." Section 900(e) was amended, however, by Section 411(b) of the Revenue Act of 1942 to define the term "transferee" *for estate tax purposes* to include not only an heir, legatee, devisee or distributee, but also to include "a person who, under Section 827(b), is personally liable for any part of the tax." As pointed out by the Court of Appeals in *Rowen* v. *Commissioner*, 215 F. 2d 641 (2d Cir., 1954), Congress did not then, nor has it subsequently, seen fit to add a similar definition to the *income tax transferee* statute.

The Government argues that the words thus added to the *estate tax transferee* statute meant nothing and were merely declaratory of existing law. This is hardly borne out by its legislative history—and the consistent failure of the Congress to make a like change in the income tax transferee statute.

It is significant that in 1954 when Congress completely rewrote the Internal Revenue Code and combined the estate and income tax transferee provisions into a single section (Section 6901 of the Internal Revenue Code of 1954), it continued this distinction in the definition of the term "transferee" for income and estate tax purposes, stating that it includes "donee, heir, legatee, devisee and distributee" for all purposes and that "*with respect to estate taxes, also* includes

any person who under Section 6324(a)(2) [similar to Section 827(b) of the 1939 Code] is personally liable for any part of such taxes" (emphasis added). It would thus appear clear that the distinction made by Congress in these two sections was deliberate.

There is sound basis for this difference in treatment. In the case of the estate tax, the measure of the tax includes the insurance, and it is therefore reasonable that the insurance should be available for payment of the tax. No such reason exists in the case of the income tax.

II. THE CASH SURRENDER VALUE AT DATE OF DEATH IS NOT TRANSFERRED TO THE BENEFICIARY

The Government contends that even if the respondent is not liable as a transferee to the extent of the entire proceeds of the policies on her husband's life, she is liable as a transferee of the cash surrender value of each of the policies at the date of his death. The theory of the Government is that the cash surrender value itself is "property" of the insured; that the insurance company maintains a "reserve fund" corresponding to this value which is used to pay the death benefit proceeds to the beneficiary; that when the insured dies this cash value "merges" into the proceeds due the beneficiary; and that in this fashion the cash value is "transferred" from the insured to the beneficiary. Govt. Brief, pp. 22-29. This line of reasoning is in all respects inconsistent with the basic concepts of the insurance contract.

It was pointed out in an earlier section that under the level premium plan of insurance, each insured pays a larger premium in the early years than he would under a yearly renewable term insurance plan and that beginning in 1854 various State laws were

enacted requiring the maintenance of reserves by the insurance companies to assure their solvency. The next step in the development of level premium life insurance was the introduction of policy provisions granting rights in the event of nonpayment of premiums. These rights developed gradually and gave recognition to the principle that neither the insurer nor the continuing policyholders should profit as a result of forfeited policies.

In 1861, the first law requiring a nonforfeiture policy provision was enacted in Massachusetts.[13] It provided that in the event of the nonpayment of premiums, an amount determined as provided in the statute should be applied to provide single premium term insurance. Under this and other early statutes, there was no provision that a cash surrender value be provided in the policy. It was not until the turn of the century that standard provision laws began to appear, requiring that policies provide for cash surrender values.[14]

Cash surrender values are precisely what their term implies—an amount available only upon the termination of the policy prior to death and for no other reason and at no other time. *Cash surrender values have nothing to do with the death benefit payable to a beneficiary.* The cash surrender value and the death benefit are separate and independent contractual rights with no part of either being related to or forming a part of the other.

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[13] *Reports and Statements on Nonforfeiture Benefits*, published by authority of the National Association of Insurance Commissioners, 1942, p. 19.

[14] Id., p. 29.

The State insurance laws dealing with nonforfeiture options in effect today require that the option values and option rights be set forth in the policy when issued, which makes it necessary for the company to fix such values in advance.[15] Thus, before issuing a class of policies, an insurer is required to make certain estimates based on assumptions as to future mortality, interest earned on investments and expenses. However, in actual experience mortality, investment earnings and expenses related to a class of policyholders may not conform with ~~the~~ assumptions. Thus the values available upon lapse of a policy are purely contractual. No fund is maintained by the insurer in connection with a particular policy which corresponds to the nonforfeiture values provided in the policy. See *United States v. Penn Mutual Life Insurance Co.*, 130 F. 2d 495 (3rd Cir., 1942).[16]

~~The~~ policy holder, on lapse of the policy, is ordinarily permitted to elect upon surrender of the policy either (a) the cash surrender value specified therein, or (b) an extended term insurance policy which will require

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[15] *Reports and Statements on Nonforfeiture Benefits*, published by authority of the National Association of Insurance Commissioners, 1942, p. 266.

[16] Kentucky law, under which the policies here involved were written, is a good illustration of the separate treatment of the reserves and of the cash value. The first Kentucky reserve valuation statute was enacted in 1870 (Section 29, Chapter 645, Laws of 1870). The first nonforfeiture law was not enacted in that state until 1893 (Section 122, Chapter 171, Laws of 1893). Appropriately, the Kentucky Court of Appeals in the case of *Mutual Benefit Life Ins. Co. v. First National Bank*, 115 Ky. 757, 74 S. W. 1066 (1903), stated, at p. 1070: "Counsel relies upon Section 653, Ky. St. 1899 [the reserve valuation section] as prescribing how policies shall be valued; but this is only for the guidance of the Insurance Commissioner in determining the solvency of the company * * *."

no further payment of premiums but will expire after a given number of years, or (*c*) a paid up insurance policy which will remain in effect until death but in a smaller amount than the original policy. The insurer has no way, of course, of knowing which of these options will be elected in the event of a lapse. "It is only by the voluntary action of the insured or by the terms of the policy, if the insured fails to act, that his rights or privileges under the policy may be accrued and determined. And until that happens, there is no definite liability or amount owing by the insurer to the insured and, hence, *no ascertainable property of the insured* in the possession of the insurer." *United States* v. *Penn Mutual Life Insurance Co., supra.*

The policyholder has no right to the cash surrender value until he exercises his option and surrenders the policy. *United States* v. *Massachusetts Mutual Life Insurance Company*, 127 F. 2d 880 (1st Cir., 1942), and cases cited therein. No debtor-creditor relationship between the insurer and the policyholder arises until these conditions of the policy are met. *United States* v. *Penn Mutual Life Insurance Co.*, and *United States* v. *Massachusetts Mutual Life Insurance Company, supra.* Under no circumstances is the insurer in possession of a fund as a trustee answerable to the policyholder. *Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25 (1909).

The Government relies on a number of bankruptcy and other cases, which have nothing to do with the trust fund doctrine or Section 311, in an effort to establish that there is a transfer of the cash surrender value of a policy to the beneficiary at the death of the insured. In *New York Life Insurance Company* v. *Statham*, 93 U. S. 24 (1876), cited at pages 22 and 27

of the Government's brief, certain level-premium policies were forfeited because of the inability of the persons insured to remit premiums to the insurers during the Civil War. After the death of the persons insured, their successors in interest sought to have the policies revived on payment of the back premiums but the insurers refused to pay anything. The Court held that the policies could not be revived, that they had been extinguished by the non-payment of premiums during the war, but that the insurers should refund the excess of premiums paid under the level-premium method up to the dates of forfeiture. There is nothing in the case to suggest that the cash values went over to the beneficiary as a part of the proceeds; on the contrary, the Court merely held that under the unusual circumstances of that case it would be inequitable to permit the insurance companies, having been relieved of their obligations to pay the death benefits, to retain the excess premiums which had been paid by the person insured.

In *Hiscock* v. *Mertens*, 205 U. S. 202 (1907), *Burlingham* v. *Crouse*, 228 U. S. 459 (1913), and *Cohen* v. *Samuels*, 245 U. S. 50 (1917), cited at pages 21 and 23 of the Government's brief, the Court was concerned with the rights of a bankrupt in an insurance policy *during his lifetime.* The bankruptcy statute vested the trustee in bankruptcy "with title to all property of the bankrupt which was not exempt"; it provided that when a bankrupt had an insurance policy which had a cash surrender value he could continue to hold such policy free from the claims of creditors provided he paid over to the trustee an amount equal to the cash surrender value at the time the petition in bankruptcy was filed. In the *Hiscock* case, the question

was whether this redemption provision applied where the policies contained no express provision for cash surrender values but the practice of the insurer was to pay such values, and the Court held that it did. In the *Burlingham* case, the question was whether the bankrupt could retain certain policies in which his estate had been named as beneficiary which had no cash surrender value, and it was held that he could. There is certainly nothing in these cases to suggest that the cash surrender value constitutes a part of the proceeds paid to the designated beneficiary at the policy-holder's death.

In the *Cohen* case the question was whether the bankrupt could be required to turn over to the trustee during his lifetime policies in which persons other than the insured's executors or estate had been named as beneficiary, or in the alternative to pay over to the trustee the cash surrender value as of the date of adjudication, and the Court held that he could be so required. There can be no doubt that during the insured's lifetime the right to take down the cash surrender value is a property right and the Court's conclusion in *Cohen v. Samuels* merely recognized the right of an insured's creditors to reach all of his property during his lifetime under the provisions of the bankruptcy statute. But this is a far different matter from holding that the insured's creditors can reach any part of the proceeds of a policy in the hands of a beneficiary after the insured's death.[17]

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[17] In *Andrews* v. *Partridge*, 228 U. S. 479 (1913) and *Everett* v. *Judson*, 228 U. S. 474 (1913), the Court held that the right of an executor to retain the proceeds of policies *made payable to the bankrupt's estate*, after the bankrupt's death, was subject to the executor's payment to the trustee of an amount equal to the cash surrender value at date of death. There is nothing in these cases

In re McKinney, 15 Fed. 535 (S. D. N. Y., 1883), also cited by the Government, involved an application by an assignee in bankruptcy for court permission to transfer to the bankrupt's widow, after deducting the cash value, a policy on the bankrupt's life payable to his estate. The bankrupt had assigned the policy to the assignee in bankruptcy, the wife had continued to pay the premiums, and the bankrupt had been discharged and later died. The Court granted the application, holding that the assignee in bankruptcy was entitled only to the cash surrender value at the time of bankruptcy, and that the death proceeds were not assets of the insured and should properly go to the widow rather than to the assignee in bankruptcy. The case provides no authority for the Government's contention that the cash values themselves are property of the insured which are transferred to the beneficiary.

The Government also cites *Rowen* v. *Commissioner,* 215 F. 2d 641 (2d Cir., 1954), *United States* v. *Behrens,* 230 F. 2d 504 (2d Cir., 1956), certiorari denied 351 U. S. 919, and *United States* v. *Hoper,* 242 F. 2d 468 (7th Cir., 1957). The *Rowen* case does hold that the cash value is property of the taxpayer which transfers to the beneficiary, although the Court concluded there was no liability under state law. The *Behrens* and *Hoper* cases hold that tax liens which attached to the cash surrender values during the lifetime of the insured could be enforced to the extent of those values

to suggest that the cash surrender value survives the death of the insured: in the absence of a specific provision in the bankruptcy statute permitting the bankrupt to retain the entire policy upon payment of the cash surrender value to the trustee, it would appear clear that creditors could reach the *entire* proceeds of a policy made payable to the estate, as well as any other assets of the estate in the hands of the executor.

against the proceeds in the hands of the beneficiaries, relying in part on the rationale of the *Rowen* case.[18]

To the extent that these cases hold or suggest that the cash surrender value is property of a taxpayer which is transferred to the beneficiary, we think they are incorrectly reasoned. They fail to distinguish between the cash surrender value itself and the right of the policyholder to elect to receive that value. The policyholder does have a property right in his option under the contract to take the cash surrender value. He does not, however, have a property right in any particular fund or monies of the company. The policyholder's contractual right to elect to take the cash surrender values does not and could not pass to the beneficiary. It may be exercised only by the policyholder. If it is exercised, the policy is cancelled and the right of the beneficiary to the proceeds never comes into being. If it is not exercised, the beneficiary has a right to receive the proceeds from the company upon the death of the policyholder. It is thus apparent that the right of the policyholder to elect to receive the cash surrender value and the right of the beneficiary to the proceeds are mutually exclusive. Consequently it is inconsistent with the provisions of the insurance

[18] Judge Learned Hand stated in the *Behrens* case that "there is no logical escape from holding that the 'surrender value' comes to an end on the insured's death," but that regardless of what he and Judge Medina might therefore have held, "had the question come up as *res nova*," they felt bound by earlier cases to conclude that the lien against the cash surrender value could be enforced against the beneficiary.

In all the other cases cited by the Government for the proposition that a lien attaches to the cash surrender value of a policy (pp. 26, 28, Govt. Brief) the lien was enforced during the lifetime of the taxpayer and no attempt was made to enforce the lien against the death benefits in the hands of the beneficiary.

contract to say that the cash surrender value itself is property of the taxpayer which is transferred to the beneficiary within the meaning of the trust fund doctrine and Section 311.

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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